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Democracy returns to Thailand

The world's silver lining

It's rough out there

PRINT EDITION

Full contents | Subscribe
Enlarge current cover
Past issues/regional covers

NEWS ANALYSIS
POLITICS THIS WEEK
BUSINESS THIS WEEK
OPINION
Leaders
Letters to the editor
Blogs
Columns
Kallery

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
International
Country Briefings Go
Cities Guide Go

SPECIAL REPORTS
BUSINESS
Management
Business Education

FINANCE & ECONOMICS
Economics Focus
Economics A-Z

SCIENCE & TECHNOLOGY
Technology Quarterly

BOOKS & ARTS
Style Guide

PEOPLE
Obituary

MARKETS & DATA
Weekly Indicators
Currencies
Rankings
Big Mac Index
Chart Gallery

DIVERSIONS
Correspondent's Diary

RESEARCH TOOLS

AUDIO AND VIDEO

DELIVERY OPTIONS
E-mail Newsletters
Audio edition
Mobile Edition
RSS Feeds
Screensaver

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Roll Call
European Voice
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Print Edition January 26th 2008

On the cover
Panic in the markets is scary. Among policymakers it makes things worse: leader

Previous print editions
Jan 19th 2008
Jan 12th 2008
Jan 5th 2008
Dec 22nd 2007
Dec 15th 2007
More print editions and covers »

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The world this week
Politics this week
Business this week
KAL's cartoon

Leaders
The markets
It's rough out there

Northern Rock
Hocking the Rock

Private spaceflight
Virgin birth

Thailand
Good riddance

Serbia's future
No place else to go

Letters
On migration, the National Health Service, Chinese exports, Bruce Forsyth

Briefing
The world's silver lining
Somewhere over the rainbow

United States
Race and the Democrats
The cooks spoil Obama's broth

The stimulus package
Full speed ahead

Barack Obama's church
Holy moly

The Republicans
McCain builds momentum

On the campaign trail
Primary colour

Health care costs
Boon or bane?

Fred Thompson bows out
Lights, camera, curtains

Racing
All bets may be off

Land use in Colorado
Where gas comes cheap

Lexington
Off the leash

The Americas
Canada
The automaton goes on and on

Mexico and NAFTA
Tariffs and tortillas

Brazil
Wolf pack

Argentina
Stop all the clocks

Asia
Environmental protection in China
Don't drink the water and don't breathe the air

Thailand's drug wars
Back on the offensive

Malaysia
Indian mutiny

Whaling
Salty shepherds

Tourism in Nepal
From treks to sex

Business
The advertising market
Hard sell

Australian media
Likely lads

The pharmaceutical industry
The bitterest pill

European business schools
Insead out?

Wireless industry
Airwaves for sale

Chinese hotels
Room at the inn

Face value
High Streiff

Briefing
Commercial space flight
Starship enterprise: the next generation

Spaceflight medicals
Suited for space

Finance & Economics
Bond insurers
Buddy, could you spare us $15 billion?

Global markets
A wild ride

The Federal Reserve
Going it alone

Pakistan's stockmarket
The world's most dangerous haven

Decoupling 1: Emerging Asia
An independent streak

Decoupling 2: Japan
Unable to fend for itself

Société Générale
Socked, not gently

Economics focus
Faulty powers

Science & Technology
Artificial life
Nearly there

Microelectronics
Eyeing up a new technology

Organ transplants
A successful mixture

Physiognomy and success
Face value

Books & Arts
Rupert Murdoch
Spend some, then spend some more

Doing business in China
By the book

Chinese and Indian capitalism
Shifting the balance

New film: "Katyn"
Unburied dead

New fiction
The winds of war

Parmigianino at the Frick
One and only

Afghanistan
Paddy re-enlists

Middle East & Africa

The Gaza Strip
Busting the blockade

Kenya
No let-up in the killing

Central African Republic
Beyond a failed state

Nigeria
Democracy by court order

Advertisement

Europe

Spain
Zapatero's bear fight

Italy's rocky government
On its way out

Italian art treasures
Coming home

Eastern Europe, America and Russia
Pipedreams

European energy
Hot air

French reforms
Attali the Hun

Charlemagne
The in and out club

Britain

Economic nerves
Nothing to smile about

Political-party funding
Hain walks the plank

The poor
Undeserving

Britain and Europe
Push-pull

Northern Ireland
The old order changeth

Reforming the police
Boys in blue head into the red 🇬🇧

Medical care
Paying a deadly price 🇬🇧

Identity cards
Dead, or just sleeping? 🇬🇧

Bagehot
In the red corner

🇬🇧 Articles flagged with this icon are printed only in the British edition of *The Economist*

International

Environment and development
How green is their growth

The Vatican and Islam
A flustered flock of pigeons

Malnutrition
The starvelings

Military helicopters
Getting boots off the ground

Advertisement

Obituary

Bobby Fischer

Economic and Financial Indicators

Overview

Output, prices and jobs

The Economist commodity-price index

Economic freedom

Trade, exchange rates, budget balances and interest rates

Markets

Gold

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Politics this week

Jan 24th 2008
From The Economist print edition

AP

Tens, or possibly hundreds, of thousands of Gazans surged into Egypt from the **Gaza Strip** after militants destroyed parts of the border wall. Gazans rushed to buy food and other supplies that have become scarce because of an Israeli blockade of the Palestinian territory, aimed at stopping rockets being fired on Israeli villages and towns. See article

At a meeting in Berlin, foreign ministers from America, Britain, France, Germany, Russia and China agreed on the draft of a third resolution on **Iran** that will shortly be put to the United Nations Security Council. But a recent American intelligence report that Iran had "halted" its weapons programme in 2003 enabled Russia and China to water down new sanctions on Iran for its defiance in continuing its uranium enrichment.

A peace deal was signed in eastern **Congo** between the government and rebel groups, including one commanded by General Laurent Nkunda. One aid organisation claims that war and related crises are costing 45,000 lives a month.

In **Zimbabwe**, police tear-gassed hundreds of protesters in Harare after they held a rally in a football stadium. They were demonstrating mainly against the parlous state of the economy; inflation is now thought to be over 50,000%, but the government has stopped counting.

Protests continued in **Kenya** against the re-election of President Mwai Kibaki in December. The death toll in widespread violence, much of it between rival ethnic groups, has exceeded 650. The government said it might set up a commission to investigate alleged ballot rigging, but the opposition said they were not consulted about the move. See article

Prodi on the brink

Italy's centre-left government teetered after two small parties withdrew their support. The prime minister, Romano Prodi, faced a nail-biting vote in the Senate, with many advisers calling on him to resign in advance. See article

The European Commission presented its proposals for allocating the **European Union's** collective emissions target, which cuts output of CO_2 by 20% by 2020, to individual countries. Months of argument and negotiation are likely to follow before the targets take effect. See article

AP

The **Greek prime minister**, Costas Karamanlis, went to **Turkey**, the first such visit by a Greek leader in almost 50 years. Although relations between the two countries are warmer than they were, big differences persist over the Aegean and, especially, the future of Cyprus.

With the government facing a tight squeeze in its public finances, more than 20,000 (off-duty) police officers from all over **Britain** marched through central London in a protest over pay, which police representatives said was a warning not to tamper with their future benefits. See article

The **French government** welcomed a plan for economic reform presented by a commission chaired by Jacques Attali, once an adviser to François Mitterrand. Observers wondered how many of the plan's 300 recommendations would ever be implemented. See article

Election process

The People's Power Party formed a coalition government in **Thailand** after the Supreme Court rejected calls for its dissolution. The PPP's leader, Samak Sundaravej, seemed poised to become the new prime minister. The party supports Thaksin Shinawatra, the prime minister deposed in a coup in 2006, who has said he plans to return from exile in May. See article

Officials in the Indian state of **West Bengal** said that an epidemic of bird flu was spreading, affecting nine of the state's 19 districts, and “getting out of hand”. They said that around 2m birds would have to be culled. Part of the border with Bangladesh was sealed.

Fierce fighting was reported from the South Waziristan district of **Pakistan**. The army said dozens of Taliban militants and several soldiers were killed. It also claimed that Baitullah Mehsud, a militant leader accused of planning last month's murder of Benazir Bhutto, has been leading attacks on army forts in the area.

Putting money in your pocket

An early bipartisan push in Congress to resolve quickly differences over George Bush's $150 billion economic **stimulus package**, unveiled on January 18th, started to fray, with some Democrats and Republicans raising doubts about the plan from the sidelines. The White House and congressional leaders remained confident they could get the legislation passed soon.

Fred Thompson pulled out of the Republican presidential running following a poor showing in the party's South Carolina primary, which was won by John McCain. The Republicans' next contest is in Florida, where Rudy Giuliani will hope to make an impact on the race. See article

The rancour intensified between **Hillary Clinton** and **Barack Obama** following Mrs Clinton's win in the Nevada caucuses. Mr Obama singled out Bill Clinton for particular criticism over his prominent role in his wife's campaign. See article

José Padilla was given a 17-year prison sentence for supporting terrorism. Mr Padilla was initially arrested in connection with an alleged “dirty bomb” plot, but those charges were dropped. An American citizen, he challenged his detention in a military brig without trial before his case was brought to court.

Defence procurement

A committee set up by Stephen Harper's government recommended that **Canada** should pull its 2,500 troops out of their combat role in Kandahar in Afghanistan unless NATO sends 1,000 reinforcements to the area and the force is backed by more airpower. See article

Mexican troops arrested a leader of the Sinaloa drug mob, following a fortnight of armed clashes in the north of the country between the army and drug-traffickers.

In an election with no opposition candidates, **Cubans** voted for a new National Assembly. Its members include Fidel Castro, Cuba's ailing leader. There has been speculation that he may step down as president next month.

Brazil said that deforestation in the **Amazon** reached a record rate in the last five months of 2007. Environmentalists blamed high grain prices for triggering an expansion of farming and ranching.

EPA

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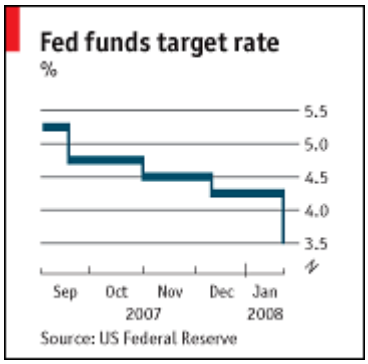
Business this week

Jan 24th 2008
From The Economist print edition

Stockmarkets around the world succumbed to another tumultuous week, falling steeply in Asia and Europe. There was much discussion about whether the American economy would enter into a deep recession and what effect it would have on the rest of the world. See article

In an effort to stave off the broadening panic, America's Federal Reserve cut its key **interest rate** by three-quarters of a percentage point, to 3.5%, the biggest single cut in a quarter of a century. The unusual intervention, one week ahead of the Fed's scheduled January meeting, soothed nerves in American markets when they reopened after a holiday. But not for long. See article



How the mighty fall

There was also much speculation about a bail-out of America's troubled bond insurers. **Ambac Financial** reported a $3.3 billion quarterly net loss after it recorded $5.2 billion in write-downs from its credit-derivatives portfolio, which includes assets backed by subprime mortgages. On January 18th Fitch cut its AAA credit-rating for Ambac, which suggests the insurers may not be reliable counterparties for the states, cities and banks that do business with them. See article

Société Générale, France's second-biggest bank, said it would write down *euro*2.05 billion ($3 billion) in assets stemming from the subprime market. It also said it had uncovered a massive fraud by a single rogue trader that would cost it *euro*4.9 billion. Its share price plummeted. See article

The shakeout from subprime markets continued to inflict pain on America's financial titans. **Bank of America's** quarterly net profit plunged by 95% compared with a year ago, to $268m. **Wachovia** saw a similar precipitous decline in its profit, to $51m.

It's tough at the top

General Motors retained the title of world's biggest carmaker, but only just. The Detroit company sold 9.370m vehicles in 2007 compared with 9.366m for **Toyota**. The sales of both have been tracked closely over the past year to see if Toyota would snatch GM's 76-year-old crown. Toyota has already overtaken Ford as the second-biggest carmaker in the United States; it is probably quite happy to let someone else enjoy the accolade of being the world's biggest.

A court in Paris prolonged the two-year saga of **Gaz de France's** attempt to merge with **Suez**, ruling that the utilities companies must provide more information to worker representatives so they could reach an opinion, a requirement under French law. The management at state-owned GDF has accused unions of stalling. The latest development frustrated investors, but the deal is still expected to close in the coming months.

Following its landmark ruling on securities litigation in the Stoneridge case, which curtails the ability of defrauded investors to sue third parties, America's Supreme Court denied an appeal from former **Enron** investors hoping to revive their $40 billion class-action lawsuit against Wall Street banks that helped to finance their deals.

Lachlan Murdoch and **James Packer** were reunited, this time in a bid to take over Consolidated Media Holdings, which retains assets of the late Kerry Packer. Both the progeny of Australian tycoons, Messrs Murdoch and Packer invested millions of dollars in One.Tel before its collapse in 2001. Mr Murdoch stood down from a management role at News Corp in 2005 but still sits on the board of his father's business. He insists that this deal is “completely my own”. See article

Vale, a Brazilian mining giant (formerly known as CVRD), confirmed that it was “maintaining a dialogue” with **Xstrata**, an Anglo-Swiss rival, but dampened speculation that a merger deal was imminent. Meanwhile, BHP Billiton indicated it would not raise its offer for Rio Tinto.

Her final bid

Meg Whitman said she would step down as chief executive of eBay, after ten years in which the online auctioneer has helped to transform business conducted over the internet. However, the company also made some disastrous decisions under Ms Whitman's tenure, including the sky-high price it paid for Skype, and she will retire with investors unhappy at eBay's stagnant share price.

Baidu.com, China's most popular internet search engine, made its first overseas foray when it launched a Japanese-language website. The move is a direct challenge to Yahoo! and Google, which dominate the Japanese market.

There was no escape for investors from the commotion in world markets this week. A financial crisis also hit **Second Life**, a popular online virtual world, which had to close the doors on a dozen banks that refused to pay out high returns on avatars' deposits.

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KAL's cartoon

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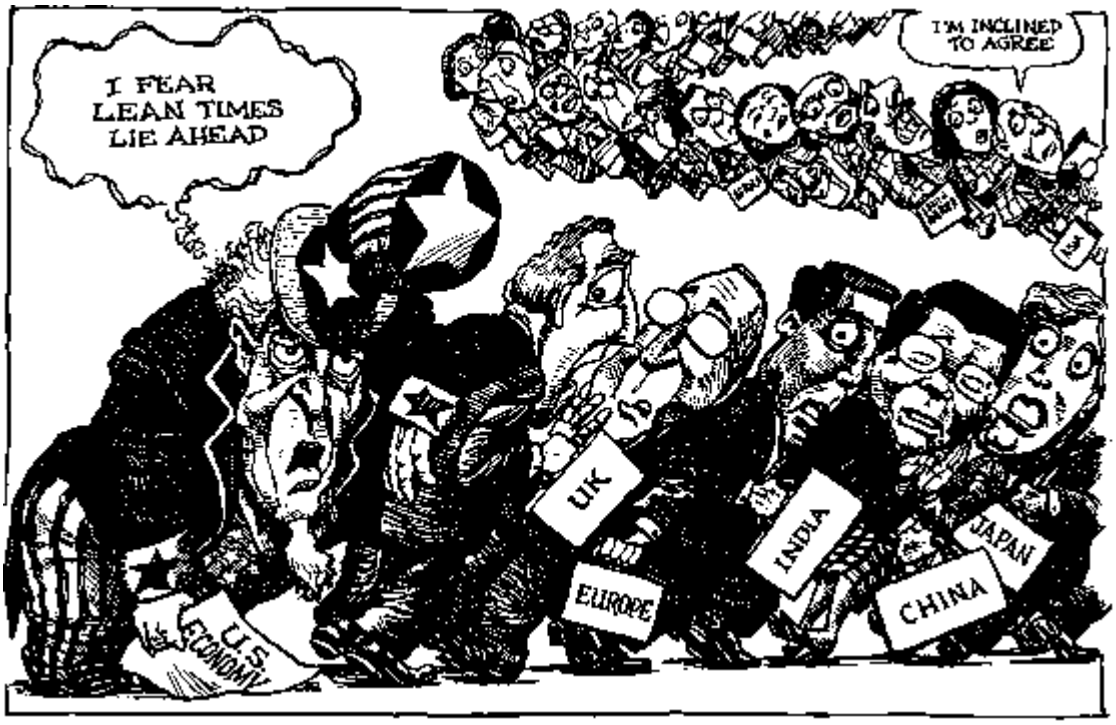
Illustration by Kevin Kallaugher



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The markets

It's rough out there

Jan 24th 2008
From The Economist print edition

Panic in the markets is scary. Among policymakers it only makes things worse

THE financial storm that blew up in America's subprime mortgage market last year has become a hurricane. The ill wind from reckless property lending blasted first the market in asset-backed securities, then banks' balance sheets and, most recently, stockmarkets. Across the globe, more than $5 trillion has disappeared from the value of public companies in the first three weeks of January. Many markets are 20% or more below their highs, the informal definition of a bear market. On January 21st share prices plunged from Brazil to Britain in the worst day of trading since September 11th 2001.

Although America's exchanges were closed that day, its policymakers' response was more than commensurate. Before Wall Street opened on January 22nd the Federal Reserve announced an unscheduled rate cut of three-quarters of a percentage point, to 3.5%, its fastest easing in a quarter of a century. A day later the New York insurance regulator and leading banks began work on a multi-billion-dollar plan to rescue the country's teetering bond insurers. As the markets pitch and yaw the pressing question is whether central bankers and regulators have acted with swift prudence, or ill-judged panic.

There is no doubt that this is a frightening moment. But the narrow economic rationale for the Fed's emergency rate-cut this week was thin. America's weak economy means monetary policy can, and should, be loosened considerably. But the central bankers' next scheduled meeting begins on January 29th. Since lower interest rates take several months to work through the economy, accelerating rate cuts by a few days will not much affect the outcome. Yes, share prices had been falling sharply across the globe, but the slide was orderly and the system had not seized up. The Fed seems to have been spooked, and wanted to stop the markets' fall (see article).

That is a dangerous path for a central bank to tread. Its success will now be identified with short-term movements on Wall Street. Indeed, as the stockmarket shrugged off the latest rate cut, the Fed's authority already looked diminished. As if to prove the point, shares soared only when the insurance regulator appeared. Ben Bernanke, Fed chairman and guardian of America's economy, moved Wall Street less than Eric Dinallo, whom nobody had heard of, saying he would rescue some insurers nobody understood (see article).

Rather than chasing the market's tail, the Fed ought to be asking what the markets' fall really signals. The answer is: unsurprising judgments that should not have led it to panic.

The Bernanke put-upon

For much of last year, stockmarkets ignored the bad news from the credit markets, thanks to three assumptions. First, that policymakers, led by the Fed, would avert recession in the United States. Second, that even if America stumbled, the rest of the world economy was “decoupled” and would carry on growing healthily. And third, that the credit mess would be confined to areas related to subprime mortgages.

These assumptions were always over-optimistic. America's economy has stalled as the building bust deepens and consumers cope with the triple whammy of falling house prices, tighter credit and dearer oil. The labour market is weakening at a pace that has in the past heralded recession. The rest of the world, meanwhile, is slowing. Europe's outlook has darkened. Its banks are embroiled in the credit crisis; and one of them, Société Générale, has lost €4.9 billion ($7.1 billion) in a fraud. Japan is weak; even turbo-charged China may cool.

And the credit crisis has continued to spread. Corporate lending and parts of consumer credit, such as credit cards and car loans, are wobbly. The looming downgrades—and possible bankruptcies—of the “monoline” insurers of some $2.4 trillion of bonds boded worse until Mr Dinallo moved. They would have hurt states and municipalities that are their biggest customers; and banks that had bought insurance in credit-derivative trades would also have been hit. A further round of losses at the banks could have been catastrophic. With the system at risk, no wonder stockmarkets swooned.

Heavy weather

None of this is exactly cheerful, but it is not disastrous, either. Particular problems, like the monoline insurers, should be dealt with by particular remedies, not the warm bath of monetary policy. It is early days, but one choice for Mr Dinallo would be to corral their worst risks in a “bad bank”, leaving the rest intact—and more tightly regulated.

As to decoupling, although the rest of the world remains somewhat vulnerable to America's troubles, most rich economies are in a slightly better shape than the United States, and most emerging ones are better able to withstand an American downturn than they were (see article). Many have plenty of reserves and flexible exchange rates, making a rerun of the 1997-98 crises unlikely. Many are growing nicely on the back of rising domestic demand and regional trade links. And many have strong budget positions, leaving room for fiscal loosening to offset weakening exports.

American policymakers also have tools to cushion—if not forestall—the downturn. Lower interest rates may not stop house prices falling, nor will they prevent banks from tightening their lending standards. But monetary policy can still stimulate the economy, as lower rates boost banks' profitability, bring down firms' borrowing costs and improve indebted consumers' cash flow (see article). Equally, fiscal policy will be a prop. Of course, President Bush promised too much when he suggested that a stimulus package would keep the economy “healthy”. But Congress is rushing the $150 billion package through, and, even if it takes a while to reach firms and consumers, it will give the economy a boost.

Taken together, the signs from the world economy are troubling. The credit binge will not unwind quickly or gently. Asset prices will fall. But central bankers and regulators have the tools to stop a downturn from becoming a slump, so long as they use them sensibly. Reacting to market panic with panicky rate cuts is likely to make things worse rather than better. The Fed should always be the calm centre of a financial storm.

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Northern Rock

Hocking the Rock

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From The Economist print edition

AP

The latest proposal for rescuing the mortgage lender is a shameless sham

CAN Gordon Brown, Moses-like, have summoned the storm that struck stockmarkets this week? Nothing less than a thunder-and-lightning extravaganza was needed to distract attention from the manifold shortcomings of his government's latest plan for Northern Rock. For four months ministers have dithered over what to do with the bust mortgage lender, victim of the worldwide credit crunch and its own recklessness, stumbling along on a £26 billion ($51 billion) loan from the Bank of England and a £30 billion guarantee to depositors. Unable to find a private buyer with access to enough cash to take the bank off its hands, the government refuses to do the politically unpalatable thing and nationalise it. The plan announced on January 21st is the worst of both worlds, and mis-sold in the bargain.

If a suitable deal with a private-sector buyer can be negotiated in the next few weeks, Northern Rock will raise the money to repay its debt by issuing some £30 billion in asset-backed bonds, which the government will underwrite. So, in this not-very-opaque shell-game, the taxpayer will guarantee repayment of the money Northern Rock borrows to repay the taxpayer. In exchange for its continued support, the government will make the bank pay a fee and will take a small stake in it; the bank's new owners will have to come up with some equity and agree not to pay themselves whopping dividends straight off. But the position will be gallingly asymmetrical: the bank's owners will pocket most of the profits, if any ensue; and taxpayers will foot most of the losses, if a lot of those materialise instead. Investors were not slow to see the opportunity: Northern Rock's shares rose by 46% when the plan was announced, on the same day as the shares of Britain's blue-chip companies fell by 5.5%.

No solution to this messy affair—a subsidised sale, nationalisation or outright bankruptcy—is appealing. The arguments for each have often been rehearsed. Nationalisation, the least bad, has the virtue of admitting where financial responsibility lies, and aligning power and potential profits accordingly. That it offends shareholders, who are rightly rewarded for taking risks when things go well, is neither here nor there.

It is taxpayers who matter: taxpayers, and honesty. To pretend that this hybrid is both a private-sector solution and the best way to see taxpayers made whole, when in fact they will be standing surety for the bank for years, is bold. Alistair Darling, Mr Brown's successor as chancellor of the exchequer, can have no such certainty, as house prices and the economy all turn down (see article). He is wise to provide few details.

Time to get tougher

Although the government is too afraid of awakening sleeping dogs to embrace nationalisation outright, it acknowledges that state ownership remains an option if negotiations with would-be buyers fall through. And if it sets the tough rules of engagement necessary to get a decent deal for taxpayers, that result becomes more likely.

Northern Rock is to pay a fee for the bond guarantee. That should be hefty: current guesses of £400m to £500m a year almost certainly understate the value in today's tumultuous markets of such a gold-bottomed undertaking. And the government wants a stake in the business, in order to profit from any upside: again, talk of 5-10% is far too modest given that the bank would not exist, still less make profits, without official backing. It would make sense, too, to insist that the bank's true owners be represented on its board. If that makes it more likely that Northern Rock's liabilities end up on the government's books, so be it.

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Private spaceflight

Virgin birth

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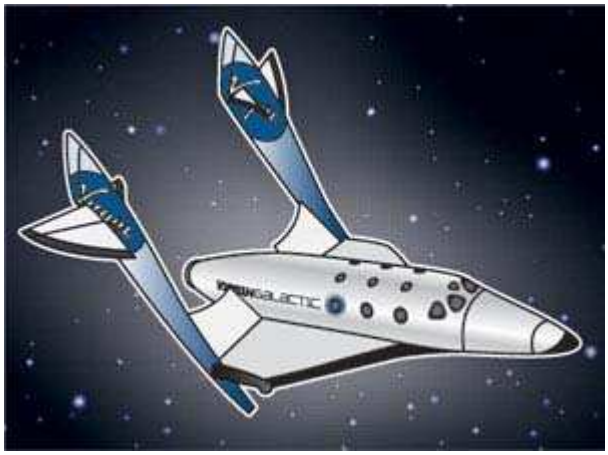
After many false starts, space tourism is about to arrive



IN OLDEN days, astronauts were fit, healthy young men with years of specialist training. Now, all that is required to show the Right Stuff seems to be a large chequebook and a reliable heartbeat. If an 88-year-old can make it through “astronaut training” (see article), then surely almost anyone can.

That is good news for Virgin Galactic, one of a number of firms proposing to take people into space at a price measured in thousands, rather than millions of dollars. On January 23rd the firm unveiled the vehicles it plans to use to give the world's moderately well-heeled pensioners (and anyone else with a couple of hundred grand to burn) the ride of their lives.

Cynics who were around at the time of the *Apollo* missions may be forgiven for thinking they have heard it all before. Then, everyone from Pan Am to British Rail imagined getting into space tourism. Indeed, British Rail took out a patent on a flying saucer. But British Rail then, like America's space agency, NASA, today, was a cosseted government bureaucracy and Pan Am, although commercial, hid behind the skirts of a protectionist American government. Both are now gone from the space race. In their place is real private enterprise: Rocketplane, EADS, Space Adventures and, of course, Virgin.

Flying 110km into space on Virgin's *SpaceShipTwo*, itself launched from a special aircraft, called *White Knight Two* (see article), is both a small step and a giant leap. It is small because, like NASA's first attempts, it is a quick, sub-orbital flight—and purists might argue that real spaceflight involves going into orbit. It is giant because no privately funded effort has come this far, nor seemed so likely to succeed.

For that success to be sustained, however, this project and its successors must bring down costs and open up new markets and different destinations. Some firms are already eyeing the moon, though that would require much more powerful rockets. Nearer to home, the antipodes also beckon. A system similar to Virgin's could be used to launch space planes that would travel from one side of the Earth to the other in 90 minutes, delivering businessmen and high-value goods: “Spacemail, when it absolutely, positively has to be there yesterday.”

Rocket man

Such applications will never be cheap; they are unlikely, for example, to usher in an era when Londoners ponder at their breakfast tables the merits of dinner (or rather, given the time-shift, a second breakfast) in Sydney. But another development of the technology may indeed become ubiquitous. That would be to use it to launch small satellites.

Satellites are just packages of electronics, and the price of electronics is falling without foreseeable end. It is the launch cost ($20m a time) that restricts their use. A successor to the *SpaceShip*/*White Knight* combination could deal with that. First, the whole caboodle is more economical than using throw-away rockets. Second, rather than having to wait ages on the ground for the right launch window, an air-launcher can fly to a better location. Such changes could bring satellite ownership to cities, universities and companies. Ultimately, it may bring it within the purse of individuals. Who could resist having their own, private window on the world?

It is famously difficult to predict the market for disruptive technologies, whether they be computers, muskets, jet engines or digital cameras. But cheap access to space, and to the other side of the Earth, is likely to be revolutionary. For many years the question has been why taxpayers should pay to put people into space. The point of private-sector space travel is that the world will rapidly and accurately come to a conclusion about what space is for. The invisible hand may, indeed, point upwards. Then again, it may not.

If it does, however, it may also point to a revolution of a different kind. Many people date the emergence of the environmental movement to the publication of a photograph taken from *Apollo 8* of the Earth rising over the lunar horizon. When space becomes a democracy—or, at least, a plutocracy—the rich risk-takers who have seen the fragile Earth from above might form an influential cohort of environmental activists. Those cynics who look at *SpaceShipTwo* and think only of the greenhouse gases it is emitting may yet be in for a surprise.

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Thailand

Good riddance

Jan 24th 2008
From The Economist print edition

After allowing Thailand's election winners to keep their prize, the generals should take their final bow

AFP

THE blundering soldiers who deposed Thailand's prime minister, Thaksin Shinawatra, in 2006 seem at last to have got something right. This week saw the restoration of an elected government following last month's election. Barring further mishap, the country seems back on the road to liberal multiparty democracy. This would be good news for the 65m Thais and would set an encouraging example for their fellow half-billion South-East Asians and the billion or more Chinese to their north. None of this, however, implies that Thailand's generals are enlightened guardians who served the national interest; still less that their coup was justified.

The junta tried its utmost to thwart the relatively benign outcome that now seems possible. It had Mr Thaksin and more than 100 colleagues banned from politics for five years. His Thai Rak Thai party was dissolved. It re-formed as the People's Power Party (PPP) and, to the generals' dismay, won far more seats than any other party in the election, just shy of an outright majority. The Thai people—particularly the rural poor who benefited from Mr Thaksin's development policies—spoke loudly. They told the military-royalist elite in Bangkok that, for all his faults, they still wanted Mr Thaksin, or a like-minded alternative. Samak Sundaravej, the PPP's fiercely right-wing leader, who cheerfully admitted to being Mr Thaksin's "proxy", was this week poised to become prime minister, at the head of a six-party coalition.

Legal shenanigans since the election might still have frustrated the people's choice. The Election Commission held an extravagant number of inquiries into allegations of vote-fiddling, mainly directed at the PPP. And the Supreme Court decided to hear several cases calling for the party's election victory to be annulled. Whether or not there was any undue pressure on these institutions, they did the right thing in the end. Not enough candidates have been disqualified or made to re-run polls to stop the election winners taking office. And the Supreme Court, sensibly, rejected the idea that the PPP itself should be banned. Further cases are pending in various tribunals but so far the omens look good.

The new government should have a workable majority—but not a crushing one like those Mr Thaksin previously enjoyed. The opposition Democrats have done a lot better than in the past two elections, so parliament may see more vigorous debate. The Election Commission has shown itself vigilant enough to suggest that Thailand's endemic vote-buying will become harder to get away with. Overall, Thai democracy stands a chance of emerging from the mess in decent shape.

It is not out of the woods yet, however. The political system is prone to too much fiery anger, wild accusation and vicious name-calling, and Mr Samak is a particularly bad offender. There are also worries he might bring back some of Mr Thaksin's worst policies, such as a "war on drugs" (see article) that appeared to sanction extra-judicial murder. Mr Thaksin's planned return from exile brings other worries.

His wife is home already and has been bailed—having pleaded not guilty—in a land-fraud case brought by an army-backed corruption inquiry. Mr Thaksin himself, relishing his victory, might orchestrate some sort of vengeance against the coupmakers, causing fresh unrest. Better, perhaps, if he keeps his promise to quit politics forever.

The last post

Better still for General Sonthi Boonyaratglin, the coup leader, and his fellow junta members to retire gracefully, forswearing political meddling to enjoy the amnesty they granted themselves. With luck, Thailand's political elite has tired of its internecine strife, and normal parliamentary politics are about to resume. The many “liberals” who despised Mr Thaksin and applauded the coup may argue that this vindicates them. Nonsense. Not only did the coupmakers fail to produce the damning evidence of corruption and abuse of power that they needed to justify removing an elected government by force. Worse, they lowered the bar for other disgruntled soldiers seeing political squabbles or corruption allegations as an excuse to seize power—not just in Thailand but in places, such as the Philippines, where democracy remains a delicate blossom.

The coupmakers failed because the interim government of bureaucrats and retired soldiers they appointed did a rotten job. This, and the uncertainty over how the junta would get out of the mess it had created, consigned the country to more than a year of slower growth. As coups almost always do, this one caused more problems than it solved.

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Serbia's future

No place else to go

Jan 24th 2008
From The Economist print edition

Serbia should recognise that it has no alternative to the European Union

AFP

LUCKY countries seldom have to think hard about where their future lies. Serbia, sadly, is not one of them. The message from the leading candidate after the first round of Serbia's presidential election on January 20th was uncompromising. The Radicals' Tomislav Nikolic, who took almost 40% of the vote, declared that Serbia must turn its back on the nasty European Union and solidify its links with the nice Russians instead. Right on cue Gazprom, Russia's energy giant, agreed to buy the Serbian national oil monopoly and to link Serbia to its planned South Stream gas pipeline (see article).

The atavistic nationalism of Mr Nikolic and his party has long been horribly obvious. The Radicals' nominal leader, Vojislav Seselj, is on trial in The Hague, charged with crimes against humanity and ethnic cleansing during the Balkan wars of the 1990s. So Mr Nikolic is standing instead. Although he did better than four years ago, he may yet lose the run-off on February 3rd to the incumbent, Boris Tadic. The suspicion in Belgrade is that Mr Tadic has struck a deal (partly involving the Gazprom agreement) to win just enough support from Serbia's prime minister, Vojislav Kostunica, to squeak back.

As even a reluctant Mr Kostunica knows, Mr Tadic is the better choice for the country. Unlike Mr Nikolic, Mr Tadic understands that Serbia needs to keep in with the EU. Yet like Mr Nikolic and Mr Kostunica, he rejects independence for Serbia's largely ethnic-Albanian province of Kosovo, which has been under United Nations supervision ever since NATO's war there in 1999. Kosovo's government is now poised to declare that independence. It has been holding back chiefly to avoid pushing more Serb voters towards Mr Nikolic. When the declaration comes, maybe next month, America and most EU countries will recognise Kosovo. Russia, however, will block any UN endorsement.

In truth, Kosovo's independence has long been inevitable. After Serbia's misdeeds in the province during the 1990s, the 90% of the population who are ethnically Albanian will never accept rule from Belgrade, even with the autonomy Serbia is offering them. Yet Kosovo's independence will still be conditional, as proposed last year in the UN plan drawn up by Martti Ahtisaari, a former Finnish president who presided over months of fruitless talks between the Kosovars and the Serbs. The Serb minority must be protected, as must the many Serbian religious sites in Kosovo. And the Kosovars must be stopped from joining up with Albania, since that would serve only to destabilise the region once again.

Keeping the Brussels door ajar

But in helping Kosovo to independence, the EU also needs to avoid provoking a hostile Serbia into making a hash of its own future. In the present climate in Serbia, that will be hard. Even if Mr Tadic is re-

elected, Serbia may not sign and ratify the “stabilisation and association agreement” that is a first step for any country towards joining the EU. Indeed, the EU may not be ready to propose a deal until the Serbs hand over another alleged war criminal, Ratko Mladic, to The Hague. Offers to work towards visa-free travel into the EU would be far more of a lure, but could take months to negotiate. For the time being, then, recognition of Kosovo's independence may well bring Serbia's progress towards the EU to a halt.

Yet politicians in Belgrade should not imagine that they have a plausible long-term alternative—least of all one of Slav solidarity with Russia. All their neighbours are trudging slowly towards EU membership. Russia cannot offer Serbia the market access, the economic development or the security partnership on an equal footing that the EU can. Its real interest seems to be to buy up Serbian energy assets on the cheap. The only lasting guarantee of peace and prosperity across the Balkans will be if all countries in the region, including Kosovo and Serbia, bury the hatchet and eventually join the EU.

A decade ago, Slovakia faced a similar choice, after it broke apart from the Czech Republic. For some years Slovak nationalists wandered off the path leading towards EU membership, following an autocratic populist, Vladimir Meciar. But Slovak voters came to realise that there was no future in that. They dumped Mr Meciar, and the country joined the EU, along with most of its neighbours, in 2004. If Serbia wants to see its luck turn, it will have to tread a similar course.

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On migration, the National Health Service, Chinese exports, Bruce Forsyth

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From The Economist print edition

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Mending walls

SIR – Your special report on migration (January 5th) discussed the flagrant inefficiency of border controls. Further to the points you raised, we have found that strengthened borders actually make it more likely that illegal smuggling networks will prosper. Tougher borders make it harder for migrants to enter a country illegally, but this compels them to deal with professional smugglers. These migrants often cannot pay the smugglers' fees up front and have to accumulate substantial debt (in the case of illegal migrants from China to the United States this can reach up to $40,000), which is then repaid through inhumane indentured servitude.

Our research has also shown that stern deportation rules make it easier for smugglers to enforce their debt-contracts with the migrants because these workers then become bound to unlawful sweatshops. Tougher deportation rules may therefore even increase the stock of illegal migrants. Moreover, these people are usually less skilled than migrants who go to societies that are more open and less reliant on deterrence.

Guido Friebel
Toulouse School of Economics
Toulouse
Sergei Guriev
New Economic School
Moscow

SIR – The movement of labour from poor countries to rich ones can hinder reform in developing economies. I lived in the Dominican Republic in the 1990s, when most Dominicans were utterly obsessed with escaping to the United States. One survey reported that 60% would leave immediately if they could (in Haiti it was 80%). By projecting their future elsewhere, people became more apathetic towards an already weak democracy, removing the pressure for meaningful change at home.

Grant Deyoe
El Segundo, California

SIR – To support your thesis that migrants benefit the economy you deployed the fallacy that Americans do not want the jobs that illegal migrants take. There is no job in this country that hard-working Americans are too lazy to do. The truth is that we are unwilling or unable to work for pennies, whereas illegal migrants are more than happy to do so. Some businesses exist solely on a flow of illegal workers who take positions with no benefits and little pay. If these jobs paid anything like a living wage Americans would work in them.

William Thompson
Columbus, Ohio

SIR – A nation has a history, a culture, an identity. Britain is not France, Spain is not Germany, and none of these are Bangladesh or Morocco. Nor do their citizens want them to become so. People do not want to be overrun by foreigners of a strange religion, a different race, or exotic (and sometimes repulsive) customs, even if it means a 1% rise in economic growth. No amount of lecturing will change these attitudes.

Thomas Farrelly
Seattle

SIR – It has been my observation that recent immigrants to the United States uphold traditional American customs and conventions quite well. They usually spend quality family time by utilising public parks and museums, shop together and often gather daily for a family meal. Many of us third- and fourth-generation Americans could benefit from emulating their values.

Rob Ryder
Columbus, Ohio

SIR – Although race, class, religion and sex have weakened as rationales for discrimination, it remains socially acceptable for geographical accidents of birth to be held against people for their entire lives. Yes, limits on immigration are necessary for all sorts of practical reasons. But they should be seen for what they are: intolerable, and therefore hopefully temporary, curbs on the freedom of people to seek happiness wherever they might find it.

Timo Hannay
London

Health matters

SIR – Regarding your article on health-care charges in Britain ("Please, sir, can I have some more?", January 12th), all publicly funded health systems have difficult decisions to make about what treatments should be made available to patients. More treatments than ever before are available on the National Health Service and cancer treatment and survival rates have improved dramatically.

A fundamental principle of the NHS, supported by all political parties, is that treatment should be available to patients based on need and not on the ability to pay. Patients are, of course, entitled to seek private medical treatment if they so wish. You mentioned a report by Doctors for Reform, a pressure group and well-known proponent of private medicine, which claimed co-payments are "already commonplace" in the NHS. Co-payments undermine the principle of fair and equal treatment for all and risk creating a two-tier health service—one for those with the ability to pay and another for those that do not. Such a system would directly contravene the principles and values of the NHS.

Ben Bradshaw
Minister of State for Health Services
London

Trade adjustments

SIR – Your article on Chinese growth and exports correctly pointed out that the headline ratio of exports to GDP overstates China's dependence on foreign demand (Economics focus, January 5th). However, the "true export ratio" shown in your accompanying graph may go too far the other way. You cited estimates of exports in value-added terms from Jonathan Anderson, an economist at UBS, that strip out the associated imports and then subtract inputs purchased from other domestic sectors. But this is only the direct value-added in China's exports; Mr Anderson excludes the "indirect value-added" generated by exports.

In order to produce exports, intermediate inputs must be used, and the production of these inputs creates the second round of value-added. This process of creating indirect value-added can be traced throughout the economy, as intermediate inputs are used to produce other intermediate inputs.

Using 2002 input/output tables and detailed trade statistics that distinguish processing and normal trade, I have developed a method to decompose China's gross exports into total domestic and foreign value-added for 87 sectors that produce goods. My preliminary estimates suggest that, in aggregate, for every $100 of Chinese exports, $51.50 is Chinese domestic value-added and $48.50 is imported value-added.

Zhi Wang
Office of Economics
United States International Trade Commission
Washington, DC

Life, is the name of the game

SIR – Although Bagehot felt the need to create a complex construct around Bruce Forsyth to make some interesting observations about Britain, he ultimately missed the point (January 5th). Mr Forsyth's enduring popularity as an entertainer lies in the fact that he is a rarity for the British Isles: consistently cheerful, smiling, positive and optimistic.

Lloyd Nathan
Hong Kong

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The world's silver lining

Somewhere over the rainbow

Jan 24th 2008
From The Economist print edition

In a week of financial uncertainty we look behind the headlines to a world that is unexpectedly prosperous and peaceful

Nature PL

POLITICIANS seem drawn to danger—as a rhetorical device, that is. George Bush justified last year's troop surge in Iraq by saying that otherwise the world would become “a more dangerous place”. Gordon Brown, Britain's prime minister, said this would be “a dangerous year” for his country. Vladimir Putin told a NATO meeting that the world had become “more dangerous” because of the Bush administration.

This sense of impending doom is not confined to politicians. Public attitudes generally seem to have become more pessimistic and inward-looking. The proportion of Americans who think their country should be active in the world (42%) is the lowest it has been since the early 1990s. Support for international trade and multinational companies is falling. Opposition to immigration is growing. Large minorities in most countries say globalisation is bad for them personally. Although the main perceived threat varies by time and place—from climate change to economic recession—the general mood is a bit despondent. And the outside world tends to be viewed as a source of trouble.

Indeed, for a great many people the way things are is pretty rotten: Burmese monks, for instance, or the Luo in Kenya. Life is not too bright for investors at the moment, either. But is the broader proposition true? Is the world really becoming worse for the majority of mankind? We argue that it is not.

To some extent, our qualified optimism is borne out by impartial data. In this article we look at three pieces of evidence: the underlying social conditions in poor countries; poverty alleviation over the past decade; and the incidence of wars and political violence. By those measures the world seems to be in rather better shape than most people realise.

Miracles behind the turmoil

In China 25 years ago, over 600m people—two-thirds of the population—were living in extreme poverty (on $1 a day or less). Now, the number on $1 a day is below 180m. In the world as a whole, a stunning 135m people escaped dire poverty between 1999 and 2004. This is more than the population of Japan or Russia—and more people, more quickly than at any other time in history.

Poverty alleviation has gone hand in hand with improvements in basic services. Digging canals and building water-treatment plants has increased the number of people with access to safe water: in South Asia, for instance, the number of those without clean water has been nearly halved since 1990. Thanks to this, and to better public-health provision, the rate at which people die from infectious diseases such as

malaria and tuberculosis is falling in most poor countries, Africa excepted.

That in turn has cut child mortality. In 2007 Unicef, the United Nations child-welfare body, said that for the first time in modern history fewer than 10m children were dying each year before the age of five. That is still an awful lot but it represents a fall of a quarter since 1990. Life expectancy has increased a bit in low- and middle-income countries. The long march to literacy is nearing an end: three-quarters of people aged 15-25 were literate in 1975; now the rate is nearly nine-tenths.

All these things are the results of patient work over many years. But perhaps the biggest change affecting people's lives has little to do, at least directly, with development policy or public spending. People in poor countries are now able to exert more control over their own fertility, and hence over the size of their families.

A generation ago the biggest worry about poor countries was over-population. Books such as “The Population Bomb” (1968) and “The Limits to Growth” (1972) predicted Malthusian crises in countries where women were having five children or more. Since then the fertility rate (the average number of children a woman can expect during her lifetime) in low- and middle-income countries has crashed. In East Asia and the Pacific, the rate was 5.4 in 1970. Now it is 2.1. In South Asia, the fertility rate halved (from 6.0 to 3.1). In the world as a whole, fertility has fallen from 4.8 to 2.6 in a generation (25 years).

The biggest decline is in those countries that are most involved with globalisation (especially in East Asia, though China is a special case because of its one-child policy). The most important exception to the rule of declining fertility is sub-Saharan Africa. All the countries with fertility rates over 5.0 are in Africa (with the one exception of Yemen).

Globalisation, it seems, leads to a shift in the direction of “replacement fertility”: the rate at which the size of a population eventually stabilises. This is a remarkable development. In closed agrarian societies, families need a lot of children as insurance against disaster. But in countries that have opened themselves up, families can rely on other sorts of protection, such as urban jobs or trade.

These demographic changes help to create a virtuous circle of growth. When fertility rises then falls, you get a bulge of people at and just after the inflection point. The baby boomers were one such bulge. Between 1960 and 1990 Europe and America had relatively few old people (because mortality rates had earlier been high), relatively few children (because fertility had fallen) and a disproportionately big number of economically active adults.

These 30 boom years were (to borrow the French phrase) “*les trente glorieuses*”. Developing countries are seeing a similar confluence now. Eventually, of course, the demographic bonus turns into a demographic onus, as is happening in parts of Europe. But that is a difficult story for a later generation. In the next one, low- and middle-income countries will have a demographic advantage to reinforce their economic gains.

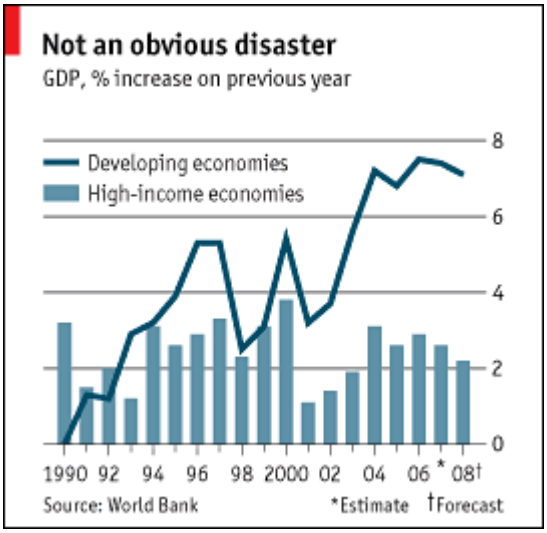
Up and up and up

These social achievements have not come about by accident. They are, at least in part, attributable to growth. A World Bank study of 19 poor countries concluded that every 1% increase in national income per head translates into a 1.3 point fall in extreme poverty. Hence the importance of the second broad indicator: the state of the world economy.

Last year the global economy entered its fifth year of over 4% annual growth—the longest period of such strong expansion since the early 1970s. Despite financial turmoil and soaring oil and commodity prices, world growth barely dipped in 2007 and trade grew at 9%, even though trade talks fell apart. Unlike previous expansions, inflation remained more or less under control.

Moreover, growth was spread around fairly evenly. According to the World Bank, national income in the European Union rose slightly more than in America for the first time in a decade. Growth in East Asia was 10%, in South Asia over 8%, in eastern Europe almost 7% and in Africa, thanks to the

commodity boom, over 6%. This was unprecedented. In earlier booms, fast growth seemed to have been the preserve of a few miracle countries, such as the Asian tigers. No longer. Almost half of humanity, spread over more than 40 nations, lives in countries growing at 7% a year or more, a rate that doubles the size of an economy in a decade. This is twice the number of fast growers that existed in the years between 1980 and 2000.



As a result, the world's economic balance is tilting from rich industrialised countries to emerging markets. Their share of world output in 2006 was just below half, and rising. The International Monetary Fund reckons that in 2008 China and India will be the largest contributors to worldwide growth for the first time.

This does not mean that the world will be able to make light of a slowdown in industrialised countries. Nor will developing countries be unaffected by problems hitting America and Europe. Nevertheless, so far they have been hit less hard by the credit crunch than rich nations were.

Yields on high-risk corporate bonds rose over 300 basis points after August 2007, an indication of the scale of damage to companies in rich nations. By contrast, emerging-market bond yields rose less than 100 points, peanuts compared with what happened after the Asian and Russian crises of 1995 and 1998. Equity markets in emerging markets, unlike those in America and Japan, shrugged off their losses last August. The view from the bond and equity markets seems to be that emerging markets are in a better position to cope with a credit crunch than rich countries are—and have grown better than they were at coping (see article).

There is a problem, however. Many people argue that the pattern of world growth over the past 20 years has not been beneficial. They point out that globalisation-driven growth has gone hand in hand with a growth in inequality. This inequality is a worry in its own right (communities get broken up; the poor get left behind) and also a missed opportunity (emerging markets might have done better still if only their extra wealth had been distributed more fairly). Is this charge against globalisation true? And, if it is, does it follow that globalisation has been a failure because its benefits have been pinched by the rich?

The evidence that the rich have done best is certainly compelling. Inequality has risen in both rich and poor countries. It is thus a sharp break from the pattern established between 1950 and 1990, when there was a general decline in inequality, notably in East Asia, where the tigers managed to combine fast growth with relatively equal incomes.

But it is not so clear that globalisation—in the sense of opening up to trade and foreign investment—is to blame. Ukraine and Poland both opened themselves in the 1990s. Yet inequality rose in Poland and fell in Ukraine. Globalisation, it seems, sometimes increases inequality, sometimes reduces it.

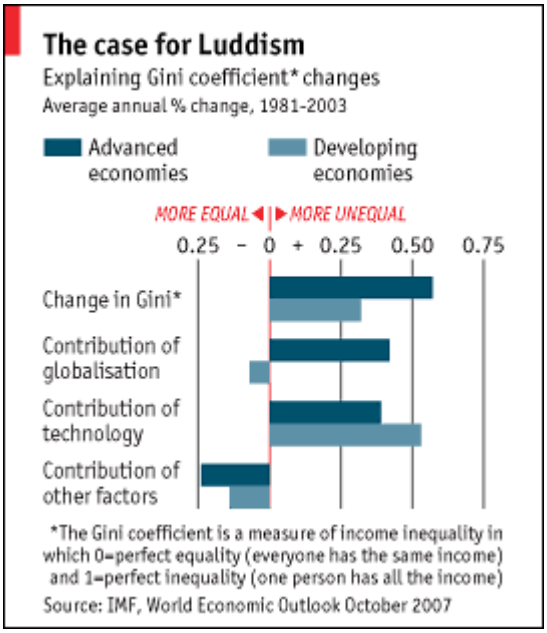
The educational ladder

A more plausible culprit for rising inequality seems to be technological progress (see chart below). This is associated with inequality in poor countries because in emerging markets the people best able to take advantage of new technology are those who already have an education and who are usually among the richest in society. The more technological progress, therefore, the better the well-off do.

But to limit technology to reduce inequality would be a cure worse than the disease. Technology in its broadest sense—the flow of new ideas—is the only way of getting growth rates up to 5-10% a year, the rate which enables poor countries to catch up with the West. Without it, growth would be dependent on labour and capital inputs, and growth would be just a few percent. To reduce technological progress—even supposing one could do it—would be to condemn poor countries to stay poor.

In fact, since the mid-1990s, the incomes of the poorest fifth have risen everywhere except, marginally, in Latin America,

where they have been affected by the after-shocks of debt crises. In Asia, the real incomes of the poorest fifth rose 4% a year; in Africa, by 2% a year, faster than the rise for other income groups.


The case for Luddism
Explaining Gini coefficient* changes
Average annual % change, 1981-2003
Advanced economies
Developing economies
MORE EQUAL
MORE UNEQUAL
0.25 - 0 + 0.25 0.50 0.75
Change in Gini*
Contribution of globalisation
Contribution of technology
Contribution of other factors
*The Gini coefficient is a measure of income inequality in which 0=perfect equality (everyone has the same income) and 1=perfect inequality (one person has all the income)
Source: IMF, World Economic Outlook October 2007

The result is that the number of very poor people in the world is falling fast—even though many critics continue to believe that the poor have not really benefited from growth. In 1990 those on $1 a day accounted for more than a quarter of the population of developing countries. By 2015, on current rates, the proportion of very poor people should have shrunk to 10%. Moreover, these monetary measures probably understate the real gains from things such as lower child mortality, safer water, literacy and other social achievements. A rich man appreciates his extra cash but this does not compare with what a poor family gains from seeing an infant survive childhood or learn to write.

The general reduction in the numbers of the very poor weakens the perceived link between globalisation and inequality. Across the world, if not within nations, globalisation can be claimed to be making people more equal, not less. This is mainly because China and India, with their 2.5 billion people, are growing fast and narrowing the gap with rich countries.

Fading trumpets of war

Economic growth improves lives unobtrusively. The more dramatic explanation for improved living standards is the decline in the number of wars, and in deaths from violence and genocide.

This explanation for prosperity will seem far-fetched to many. International opinion has long held that the end of the cold war unlocked a Pandora's box of ethnic violence that superpower rivalry had kept contained (the splitting of Yugoslavia being the classic example). Most people believe that the number of wars has increased; that conflicts have become deadlier (Iraq is typical); and that there are more acts of genocide (Darfur being just the most recent). Yet there is surprisingly little evidence to back up this impression.

The number of conflicts (both international and civil) fell from over 50 at the start of the 1990s to just over 30 in 2005 (definitions are obviously fluid; these are the ones used by scholars at the universities of Uppsala and British Columbia for a project called the “Human Security Report”). On their definitions, the number of international wars peaked during the 1970s and has been falling slowly since. The number of civil wars continued to rise until about 1990 and then fell precipitately. In total, the death toll in battle fell from over 200,000 a year in the mid-1980s to below 20,000 in the mid-2000s.

Such numbers are subject to error and dispute. Figures from the World Health Organisation, for example, are much higher. Still, the direction of change does look plausible. In general, the number of new wars, and new episodes in old wars, seems to be falling. More recently, 2006 saw a war in Lebanon, violence in Congo and conflict in Nepal, Somalia and Timor-Leste. By 2007 those struggles had simmered down, somewhat.

You see a similar pattern with the worst of crimes, genocide. At the moment, Darfur is a stain on mankind. But in a quantitative sense, the late 1980s and early 1990s were worse: that period saw ten cases of the mass slaughter of civilians, says Barbara Harff, of the US Naval Academy, including Bosnia, Rwanda and Burundi.

The cold war itself was not all that frigid. The protagonists fought their wars by proxy: about a third of conflicts from 1950 to 1990 were connected to cold-war rivalry. In addition, during the early years of that period, there were many wars between retreating colonial powers and independence movements, a source of violence that has almost disappeared. All this is hard to square with the notion that wars have become more frequent and deadlier since the end of the cold war.

On the other hand, there has been a dramatic rise in the number of conflicts resolved. During this decade civil wars have come to an end or have been restrained in Aceh, Angola, Burundi, Congo, Liberia, Nepal,

Timor-Leste and Sierra Leone. These places then drop out of the news. As Sherlock Holmes remarked of the curious incident of the dog at night (“The dog did nothing in the night-time...That was the curious incident”), events that do not happen can be as revealing as those that do.

A big exception to the rule of declining political violence is the rise of terrorism. Despite claims to the contrary by the Bush administration, the number of international terrorist incidents has risen since September 11th 2001, after a decade of decline. The number of deaths from terrorist acts has climbed almost everywhere. Yet this picture of worldwide growth is misleading. While it is true that Asia, Latin America and Europe have all experienced more terrorist attacks than before, they are still rare. Since 2001, the Middle East has suffered more violence and fatalities than the rest of the world put together.

Violence in the Middle East is a reminder, as if one were needed, of the many ills—climate change, greenhouse gases, chronic diseases in poor countries and much, much more—that need to be set against the achievements of the past few years. But the successes provide some perspective, both to the extent of the world's persistent problems, and to their setting.

Fragile: do not drop

An extraordinary concentration of misfortunes is to be found in a group of countries which the World Bank labels “fragile”. This is a slightly larger category than the so-called failed states, such as Somalia, where the central government has ceased to exist. It includes countries where the government has partial control of territory (Sudan), where it cannot deliver basic services (Zimbabwe) and places with high levels of political conflict (Nigeria).

Fragile states contain roughly half the developing world's childhood deaths. About a third of their people are undernourished and more than that do not have access to drinking water. They usually have extremely high fertility rates: most of the countries with fertility rates over 5.0 are fragile. In one way or another, they are much more likely to be affected by wars, refugees and every sort of political crisis.

Bad government and lack of growth often, though far from always, go together. Whatever the problems of globalisation, they are dwarfed by the penalties of being untouched by it. The World Social Forum, a gathering of self-proclaimed progressives who want to turn back trade, growth and globalisation has adopted as its slogan the motto “Another world is possible”. In reality, another and better world is painfully and fitfully coming into being.

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Race and the Democrats

The cooks spoil Obama's broth

Jan 24th 2008 | LAS VEGAS
From The Economist print edition

An ethnic split in the Democratic race hurts both leading candidates—perhaps to the advantage of Republicans come November

EPA

“I DON'T want us to get drawn into this notion that somehow this is going to be a race that splits along racial lines,” said Barack Obama in a debate on January 21st. Well, too bad. As the Nevada caucuses had showed two days earlier, and as South Carolina's primary election is likely to confirm, Democratic voters are already divided along racial lines. The real issue is who will suffer more from this divide, Mr Obama or his main rival, Hillary Clinton, and whether the split might end up costing their party the White House.

Mr Obama's candidacy at first seemed a post-racial triumph. While he rarely addressed the issue directly, he seemed to embody the hope that America could transcend its divisions. Iowa's lily-white electorate flocked to him joyfully. But Mr Obama's victory in the caucuses there provoked attacks by Mrs Clinton's allies, which some blacks interpreted (a touch tendentiously) as ethnic slights. Then, just as things were beginning to calm down, Nevada's Hispanics waded into the fray.

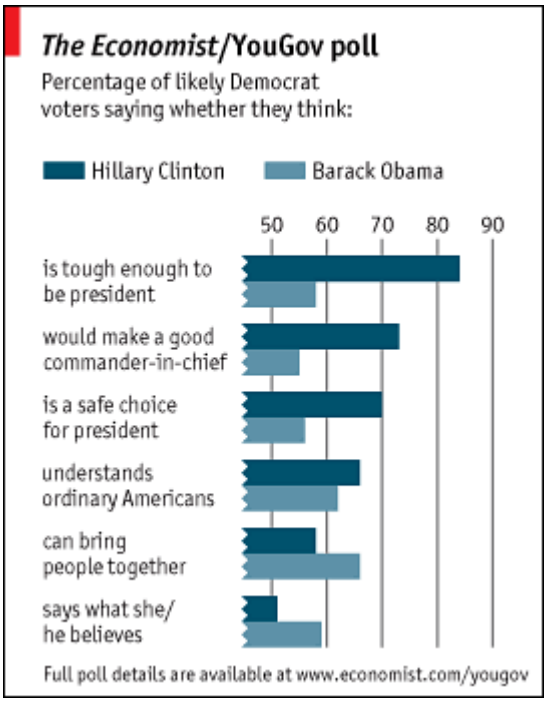
In a convention room above the New York-New York casino in Las Vegas, a strong ethnic pattern became apparent as soon as the caucus opened. Defying their union, which had endorsed Mr Obama, a procession of Hispanic maids and short-order cooks headed to Hillary Clinton's corner. Thanks largely to them, she won that caucus by 95 votes to 70 and went on to take seven out of nine contests on the Las Vegas strip. A CNN poll suggests the pattern was repeated across the state. Latinos, who made up 15% of caucus-goers, gave Mrs Clinton a 38-point lead. Blacks favoured Mr Obama by 69 points.

Few expected that so many Latinos would turn out, or that they would plump so heavily for Mrs Clinton. Fearing the might of the Culinary Workers Union, which represents casino and hotel staff, her allies had launched a legal challenge to the very caucuses she ended up winning. One reason the workers broke ranks, said Luis Rueda, a casino porter and shop steward who voted for Mrs Clinton, is that union leaders seemed to decide the endorsement without consulting their members.

Hispanic voters are drawn to Mrs Clinton for many of the same reasons others are: they remember the 1990s fondly and warm to her message of hard work and responsibility. Many also admire her for holding together a family that includes a philandering husband. Yet cruder notions may have influenced some. It would not be the first time that Hispanic voters had been put off by a rival candidate's race.

Because so many of them are young or illegal, Hispanics have much less power than their numbers would suggest. It was not until 2005 that Los Angeles, then almost half Latino, elected a Hispanic mayor. This is vexing enough. What sharpens Latino resentment and gives it a racial edge is that many live in areas where blacks hold power. In California's 37th congressional district, for example, which includes parts of south-central Los Angeles, Latinos outnumber blacks almost two to one. Yet black politicians invariably carry the area. Last year, in a special election, a Latina stood against two African-American candidates. If the black vote had split, she might have won. It did not, thanks in part to pleas for unity from black leaders, who made it clear that they did not want the seat to change colour.

Such slights are not soon forgotten, and may be returned in kind. In 2001 almost three-quarters of Houston's Hispanic voters rejected a black Democratic candidate for mayor in favour of a blue-eyed, conservative Republican who happened to be Cuban. When Latinos do wield power over blacks, as in Miami and the southern California city of Lynwood, they often do so unapologetically. After all, they feel no responsibility for slavery and segregation, or their lingering effects. Mr Obama has pointed out that Hispanics voted for him in Illinois. He fails to mention that his opponent in the 2004 Senate race was Alan Keyes, who is not only black but also claimed to be more so than Mr Obama.



The senator from Illinois has at once the most to gain and the most to lose from a racially divided electorate. If they had to choose, Democratic candidates would probably pick the black vote over the Latino one: it is bigger and more partisan. But the real prize is not the black vote or the Latino vote but the white vote. A fractious contest threatens to turn Mr Obama from a post-racial into a racial candidate. Small wonder that, in this week's debate, he strove to avoid discussing race, preferring to talk about “low-income people” and the need to “bring the country together”.

There were signs in Nevada that some damage may already have been done. Mr Obama was soundly beaten in Henderson, a mostly white, middle-class suburb of Las Vegas. (It helped that Mrs Clinton hammered the issue of home foreclosures, a big problem locally, during a well-attended rally in the city.) The next challenge is South Carolina, where blacks make up about half of the Democratic electorate. To its discredit, Mrs Clinton's campaign has already put it about that black voters are likely to tip the state to Mr Obama. An impressive victory would thus be spun as a simple matter of ethnic allegiance.

This is a very dangerous game. In nine months the entire country will go to the polls. Without black voters, the Democrats would struggle to win in the Midwest and could not compete in the South. Without Latinos, their dreams of seizing western states like Colorado and Nevada would be much less likely to come true. The risk for the eventual nominee, whether Mrs Clinton or Mr Obama, is that an alienated group might tend to stay at home in November—or, worse, send a bundle of votes to a centrist Republican xenophile like John McCain. If that happens, the White House could be lost.

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The stimulus package

Full speed ahead

Jan 24th 2008 | WASHINGTON, DC
From The Economist print edition

A deal is reached, it seems, on a stimulus package

Reuters

Team-work

TWO things that almost never happen in America looked set to occur on January 24th. As *The Economist* was going to press, Democrats and Republicans had reportedly reached a deal on how to stimulate the floundering American economy. And the bickering, slothful Congress seemed likely to pass some important legislation quickly.

Perhaps one should not be too surprised. After all, everyone agrees that the economy is in a terrible pickle. The problem is not so much in the stockmarket, which was buoyed this week by a drastic interest-rate cut by the Fed and a move to rescue bond insurers. The housing market is in turmoil: construction has plunged, house prices are falling and there seems no end in sight. So much of a typical American's wealth is tied up in bricks that the threat of house-price deflation stokes panic. Politicians rarely need an excuse to shower grateful constituents with other people's money. Now they have a powerful one.

President George Bush aims to trumpet the whole completed package in his state of the union speech on January 28th. But several details have already leaked. Households will receive tax rebates of between $300 and $1,200, depending largely on how many children they have. Pressure from Democrats ensured that even families too poor to pay taxes will benefit. Republican pressure ensured that even couples who earn as much as $150,000 a year will gain too.

The package also apparently includes tax cuts for businesses, giving firms incentives to invest in new factories, showrooms, machine tools and so on. Small firms will enjoy laxer rules on writing off expenses and ailing firms will get rebates for taxes already paid.

To help the housing market, the package includes a plan that will allow Fannie Mae and Freddie Mac—two huge government-backed firms that finance and guarantee home loans—to buy up mortgages much larger than the $417,000 maximum currently permitted. Critics worry this will only delay a necessary correction in the housing market; but they will probably be ignored.

Both parties have compromised. Democrats wanted to expand food stamps and unemployment benefits, but have backed down. Republicans wanted to target the rebates at those that pay income taxes, but

have reportedly agreed to extend them to the very large number of Americans who do not.

The package could be passed by Congress in as little as a week or two. Divided government means that both parties could get blamed for a severe recession, and neither wants that with an election looming. One should never underestimate the capacity of individual senators to delay even the most popular bills, but the mood in Washington is for action, bold and speedy. Whether the stimulus package will prevent a recession is anyone's guess.

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Barack Obama's church

Holy moly

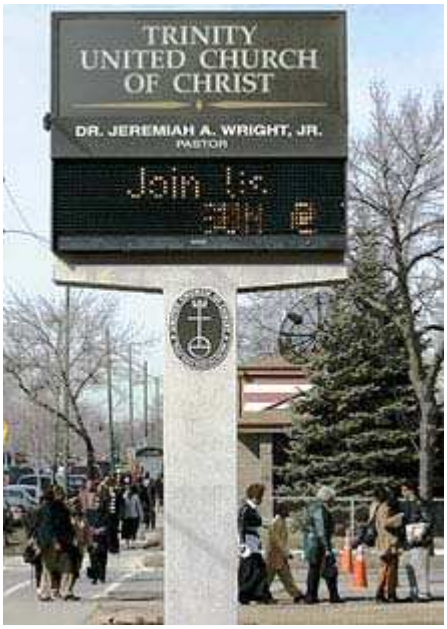
Jan 24th 2008 | CHICAGO
From The Economist print edition

The tumult over Barack Obama's church

ON THE eve of Martin Luther King day, Barack Obama took to the pulpit to talk about race. It was a powerful moment: a black candidate speaking in King's former church in Atlanta. “We can no longer afford to build ourselves up by tearing each other down,” he declared, calling for all races to unite. The speech at King's church was, above all, inclusive. Unfortunately, Mr Obama's own church is accused of being the opposite.

Mr Obama has been a member of Chicago's Trinity United Church of Christ for 20 years. Some conservatives are criticising the church's motto of being “unashamedly black and unapologetically Christian”. A mysterious mail campaign claims the church is racist. Is it truly a liability for the candidate who claims to transcend all that?

AP



All welcome

Two lines of criticism have emerged against Trinity. The first concerns its basic mission. Trinity's “black value system” includes a commitment to the “black community” and the “black work ethic”. Tucker Carlson, a pundit for MSNBC, calls this a “racially exclusive theology”. Sean Hannity of Fox News mischievously suggested taking Trinity's mottos, exchanging “white” for “black” and imagining the outrage that would cause.

Dwight Hopkins, a professor at the University of Chicago and a member of Trinity, counters that the ethnic identification of churches is “a very American Christian practice”. Every denomination has its own sects—look at Latino Pentecostal churches. Trinity is in the poor, mostly black South Side; its message of black self-help reflects this. But whites are made perfectly welcome when they attend.

The second line of criticism is aimed specifically at Jeremiah Wright, Trinity's pastor, who will retire this year. On January 15th a columnist for the *Washington Post* wrote that Mr Wright admires Louis Farrakhan. Mr Obama promptly condemned the “anti-Semitic statements made by Minister Farrakhan”, and has also stressed that Mr Wright sometimes says things “that I deeply disagree with”. But the candidate is careful to maintain his connection to Trinity. As a young community organiser in Chicago's poorest areas, he was struck by Mr Wright's message of linking the Bible to black self-improvement. It was at Trinity that Mr Obama nurtured both his faith and his racial identity.

Trinity might remain a point of strife if Mr Obama wins the Democratic nomination, though most Americans will not be surprised that a black man belongs to a black church. It will help that he has held “faith forums”, explaining his faith and urging others to share theirs. But it is still a tricky balancing act.

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The Republicans

McCain builds momentum

Jan 24th 2008 | ABOARD THE USS YORKTOWN
From The Economist print edition

John McCain is now the Republican front-runner, but trip-wires await

THE day before South Carolina's Republican primary, John McCain held a rally on an old aircraft carrier, the USS *Yorktown*. The backdrop worked. Voters were reminded of the Arizona senator's heroism. Shot down over Hanoi in 1967, he broke both arms and a leg, was captured and tortured, yet refused to be freed unless his fellow prisoners came too. His hair turned white, and to this day, he cannot raise his hands high enough to comb it.

Yet there is vigour in the old warrior. He won South Carolina handily, beating Mike Huckabee by 33% to 30%. Added to his earlier win in New Hampshire, this has made him the favourite, albeit an uncertain one, to win the Republican nomination. And the polls, for what they are worth, show him beating either Hillary Clinton or Barack Obama in November.

AP

Character is destiny

Victory in South Carolina was especially satisfying. Before Mr McCain's speech on the *Yorktown*, Phil Gramm, a former senator, praised his wife, Cindy McCain, noting her decision to adopt a Bangladeshi orphan who might otherwise have died. Nothing was said, but everyone in the audience remembered the unwitting role the McCains' adopted daughter played in the South Carolina primary in 2000. Someone spread the utterly false rumour that she was the result of Mr McCain's adultery with a black woman. In the South, such libels hurt. George Bush trounced Mr McCain in South Carolina, ending his candidacy.

That was back when America was at peace. Now it is locked in a struggle it looked like losing until President Bush took his old rival's advice and sent more troops to Iraq. On January 18th, *USA Today* reported that Baghdad was 75% secure. Mr McCain drew parallels between the Americans serving in Iraq and the “greatest generation” that fought against Japan. The *Yorktown*'s toughest foes, he said, were also suicide-bombers.

South Carolina is home to many soldiers, serving and retired. They admire Mr McCain, but that is not why he won. “It's a question of character,” says Brian Thomas, who sells construction materials. Mr McCain strikes him as a man of greater steadfastness and integrity than his rivals. “I'm actually against the war in Iraq,” says Mr Thomas, “But now we're there we have to finish it. And he's the man to do it.”

The week's big losers were the two Southerners, Mr Huckabee and Fred Thompson. Mr Huckabee, a former governor of Arkansas who won the Iowa caucuses earlier this month, cranked up the good ol' boy charm an extra notch in South Carolina. In Clemson, a college town, he told a joke about two boys from New York who decide to take up farming. They need a mule. A storekeeper sells them two “mule eggs”—watermelons. Their truck hits a bump, and one melon falls off and shatters. A jackrabbit starts nibbling it. The city boys think it has hatched a baby mule. They chase it. It whizzes off. One city boy is upset. The other figures it is not so bad: he wouldn't want to plough that fast anyway.

Running for president, said Mr Huckabee, is like ploughing that fast. And despite his impressive loss of weight, it seems Mr Huckabee can't handle the pace. He did well among evangelicals. But he failed to build on this base. His bashing of big corporations and vow to abolish the Internal Revenue Service won over some populists, but not nearly enough. If he can't win in the South, his home region, how can he prevail nationally?

Mr Thompson, a former senator from Tennessee who was counting on a win in South Carolina to revive his comatose campaign, came third and duly dropped out (see article). Mitt Romney, a former governor of Massachusetts who won in Michigan last week, came fourth. But this hurt him less than it might have done. Realising that he was going to lose South Carolina despite spending a fortune on television spots, Mr Romney abandoned the state and campaigned instead in Nevada, which also voted on January 19th. Mr Romney won there with a hefty 51% of the vote; Ron Paul, a libertarian, came second with 14%. Mr Romney's rivals scoff that anyone can win a state where no one else campaigns. His boosters say he played a poor hand deftly. Either way, he lives to fight again in Florida on January 29th.

The polls predict a four-way scrimmage in Florida. Rudy Giuliani, a former mayor of New York who skipped the previous primaries to concentrate on the Sunshine State, is ailing but still dangerous. Mr Romney and Mr Huckabee are battling to pick up Mr Thompson's conservative supporters. Mr McCain has momentum and hopes to win Mr Thompson's endorsement—the two men are friends, even if their supporters have little in common. Anything could happen.

Right-wing talk radio hosts are bursting their cheeks over Mr McCain's resurgence, for three reasons. Mr McCain sponsored a liberal immigration bill (which failed) and a restrictive campaign-finance law (which passed). He also opposed Mr Bush's tax cuts (because, he protests, they were not balanced by spending cuts). Rush Limbaugh, the most popular of the talk radio crew, says a McCain nomination would destroy the Republican Party. But judging by Mr McCain's success so far, not all Mr Limbaugh's “dittoheads” (as his fans call themselves, since they agree with him so often) agree.

In Florida, however, Mr McCain will lack one advantage he enjoyed in South Carolina. Florida's primary is “closed”. That is, only registered Republicans can vote. In South Carolina, independents can vote in either primary. Among those of them that voted in the Republican primary, Mr McCain led by 17 percentage points. He is much weaker among hard-core conservatives. At a gun show in South Carolina on primary day, where tables buckled beneath rifles, pistols, crossbows, machetes and even a spiked club, it was hard to find a single McCain fan. “He sided with the Kennedy guy [Ted Kennedy] on giving the illegal aliens Social Security benefits,” complained Paul Bennett, a gun salesman, “I just can't believe that!”

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On the campaign trail

Primary colour

Jan 24th 2008
From The Economist print edition

The rules of the game

“Because I'm an ordinary person, I thought that they meant, 'What's your biggest weakness?' If I had gone last I would have known what the game was. And then I could have said, 'Well, you know, I like to help old ladies across the street. Sometimes they don't want to be helped. It's terrible.'”

Barack Obama explains why his admission during a debate that his paperwork was disorganised came to be used against him. Associated Press, January 18th

New best friend

“It took us a while, but what's eight years among friends?”

John McCain's victory speech after winning in South Carolina, January 19th

The Young and the Restless

“I'm afraid I may have to send my 95-year-old mother over and wash Chuck's mouth out with soap.”

John McCain, campaigning in Miami, responds to Chuck Norris's comments about his age. Mr Norris, a Mike Huckabee supporter, is only four years younger than Senator McCain. CNN.com, January 21st

Vegas, baby

“I would kind of like to go back to the old Las Vegas saying, though. You know, 'What happens in Vegas stays in Vegas'? I hope that turns out to be true in this case.”

John Edwards plans to get past another loss. CNN, January 20th

Southern comfort

“You don't like people from outside the state coming in and telling you what to do with your flag. In fact, if somebody came to Arkansas and told us what to do with our flag, we'd tell them what to do with the pole, that's what we'd do.”

Mike Huckabee, campaigning in South Carolina, raises the non-issue of the Confederate flag. CNN.com, January 17th

White men can't dance

“I would have to, you know, investigate more of Bill's dancing abilities, you know, and some of this other stuff before I accurately judge whether he was in fact a brother.”

Barack Obama, in a South Carolina debate, questions Bill Clinton's status as the first black president. January 21st

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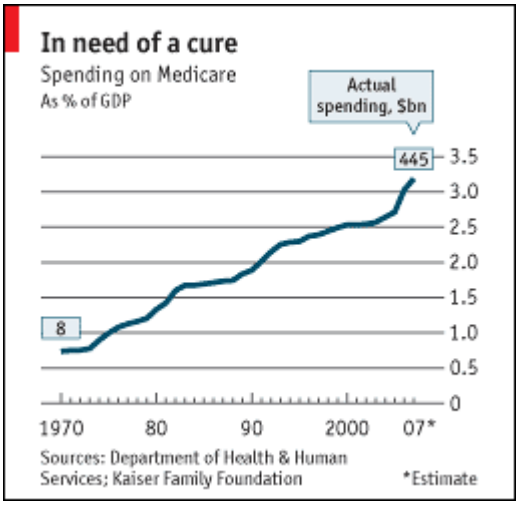
Health care costs

Boon or bane?

Jan 24th 2008 | NEW YORK
From The Economist print edition

Medicare spending is soaring, but could that ultimately harm the elderly?



WHEN George Bush signed a controversial bill that reformed Medicare, the government health plan for the elderly, into law back in 2003 he declared it would be "the greatest advance in health-care coverage for America's seniors since the founding of Medicare." The reform's central provision, known as Part D, subsidises the supply of prescription drugs by private insurers. Critics mocked the chaotic launch of that scheme, and feared its huge cost would end up wrecking the budget.

So who got it right? At first blush, it would seem that Mr Bush did. Despite those teething pains, the Part D plan has taken off in earnest. Many millions have signed up, and private insurers have flocked to the scheme. Polls show the plan is popular. But look closer and the plan's warts appear. For one thing, as predicted, it is hugely costly. The official Centres for Medicare and Medicaid Services recently estimated that while overall health spending grew only 6.7% in 2006 to $2.1 trillion, about the same rate of increase as in 2005, Medicare spending shot up 18.7%—double the rise a year earlier and the fastest since 1981. That could well affect the elderly in coming years by forcing the government to make cuts elsewhere.

Mindful that recession may be coming, Democrats are now trying to boost spending on Medicaid, the government health scheme for the poor, by tacking on provisions to the big economic stimulus package wending its way through Congress. Bush administration officials have made clear they will not allow cuts in Part D, as some Democrats propose, so how to pay for this is unclear. What is clear is that costs are already squeezing Medicare, as a big row over doctors' pay reveals.

Doctors and hospitals already had a disincentive to take on Medicare patients, as cost-cutting laws enacted by Congress years ago were anyway hurting their margins. But in late December, Congress went further, and very nearly enacted a mandatory 10% cut in doctors' reimbursements for Medicare patients. In the end, doctors got a six-month reprieve; efforts are now under way in the Senate to extend that reprieve for a further two years. If such cuts go through, most doctors will think again about treating Medicare patients.

Mr Bush's Medicare reforms are popular today, but a backlash may be coming. Some private firms have been caught manipulating the elderly into signing up for inappropriate plans. Questions are being asked about why the public is subsidising the marketing expenses of pharmaceutical companies—expenses that the public sector does not incur. Those doubts will turn into howls if Part D puts the rest of Medicare under the scalpel.

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Fred Thompson bows out

Lights, camera, curtains

Jan 24th 2008 | ANDERSON, SOUTH CAROLINA
From The Economist print edition

A lacklustre campaign limps to a halt

HE SLOUCHED onto the stage to light applause. He rambled like a man with his mouth full and nothing particular on his mind. He played up his Southern roots. “It's good to be back where people know how to cook green beans,” he said, referring to the Southern habit of boiling them to death. The audience chuckled, but they numbered only a few dozen. Most of the folks at Ryan's steakhouse paid more attention to the buffet than to Fred Thompson.

Mr Thompson, a former senator from Tennessee, gave up running for president this week after failing—by a wide margin—to win the Republican primary in nearby South Carolina. Rarely has a candidate disappointed so many supporters so quickly. Last year, when conservatives were searching desperately for someone both solidly conservative and electable, Mr Thompson's name came up. He is a movie star with a commanding voice, they reasoned. Perhaps he will turn out like Ronald Reagan. He didn't.

Unlike Reagan, who was governor of California before he became president, Mr Thompson has no executive experience to speak of. He had coherent policies—his belief in federalism is heart-felt, and someone put some work into his plan for Social Security. But he is a lazy and disorganised campaigner, so few voters ever found out where he stood.

To his fans, Mr Thompson was the real thing: pro-life, anti-tax, plain-spoken and unlikely ever to change his mind about anything. “I've driven all around this country and I see what's going on,” said Bob Wilkes, a craggy truck driver at Ryan's steakhouse. There are, apparently, too many illegal aliens, too much welfare and a younger generation that's all “me, me, me”. Mr Thompson is the best candidate to protect the country, said Mr Wilkes. He must be sad.

Mr Thompson's exit will benefit one of his rivals, but it is unclear which. Mr Huckabee is now the only Southerner in the Republican race. Mitt Romney is the only “full-spectrum” conservative; at least, he claims to be. Mr Thompson himself is said to prefer John McCain. But any of these candidates could grab some of his supporters, as could Rudy Giuliani. Mr Thompson, meanwhile, can always go back to playing presidents on the screen.

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Racing

All bets may be off

Jan 24th 2008 | NEW YORK
From The Economist print edition

Off-track betting in New York could be in its final stretch

THE city that doesn't sleep is not allowed to do a host of naughty things: the strip joints were pushed out of Times Square years ago and smoking in bars, restaurants and other public places was prohibited in 2003. New Yorkers can no longer talk on mobile phones in cars or in schools. Nor can they eat what they want: the city has banned artificial transfats in restaurants. The police began carrying around decibel metres last summer to enforce new noise ordinances. Now, it looks like gambling may be the next to go.

AP

One step ahead of the creditors

New York's Off-Track Betting Corporation (OTB), the city's quasi-public bookie, revealed a plan last week that may shut down its entire operation by mid-June. Although the OTB grosses $1.1 billion a year and 1.6m wagers are placed daily, most of the takings are used to pay off winning bets and on operating costs. Some of the remaining $125m is disbursed to the city and to New York state, but a large chunk ends up in the racing industry's coffers. Michael Bloomberg, New York's mayor, contends these payouts exceed net profits, creating deficits going back at least five years and a projected $13m operating loss for 2008.

The OTB has in effect been operating in the red for years, but has used its reserves to keep going. By this summer it will need a cash infusion just to make ends meet. Mr Bloomberg has said he has no intention of subsidising the largest legal gambling operation in the country—not least because the city's share of the revenues has dwindled while those of the state and the racing industry have grown.

The OTB was originally designed to raise money for the city and the state and to take gambling out of organised crime's control by providing a legal outlet for betting. During the 1980s, it earned the city $65m a year. Just seven years ago the entity was almost sold for $250m. Today, its bleak-looking parlours are frequented by an ageing, dwindling base of punters.

Bennett Liebman, who heads a racing think-tank at Albany Law School, thinks closing the betting shops is a mistake but also that government shouldn't be in the gambling business in the first place. He thinks the mayor's threat to shut up shop may be just a bluff in an attempt to wrest more money from the state, which is busy with another racing-industry crisis.

New York's state legislature is in the middle of negotiating a new franchise to see who will operate the

state's three thoroughbred racetracks. Eliot Spitzer, New York's governor, wants the franchise to remain in the hands of the New York Racing Association (NYRA) for another 30 years. The NYRA's track record is not impressive. It has spent the best part of a decade mired in scandal (it has been under federal and state investigation), financial distress (bankruptcy) and inefficiency. Its franchise expired on December 31st. It has been given two temporary extensions, while the politicians continue to hammer out a deal.

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Land use in Colorado

Where gas comes cheap

Jan 24th 2008 | GARFIELD COUNTY, COLORADO
From The Economist print edition

Saving the mountains from the oil prospectors

A FEW miles up county road 215, north of the town of Parachute, the mountain valleys are criss-crossed with dirt roads and dotted with drilling rigs and natural-gas wells. This area, privately owned by EnCana, an exploration company that operates 2,800 gas wells in the region, is one of many drilling hotspots in Garfield county, the centre of a gas boom in north-western Colorado.

Improved extraction technology and high gas prices mean the boom here shows little sign of slowing. But some worry that rapid energy development into increasingly remote areas will ruin Colorado's dramatically beautiful mountain landscape. The sharpest controversy is over proposed drilling on public land on the Roan Plateau, a 200-square-mile (518 square km) area near Parachute that is still relatively wild. Last June the federal Bureau of Land Management (BLM), which controls 8.3m acres (3.4m hectares) in the state, announced a management plan allowing for up to 1,540 wells on 53,000 acres of gas-rich land on and around the plateau.

A number of wilderness-protection advocates and hunting organisations are urging Colorado politicians to block the plan. So far, efforts in Congress to ban drilling on the plateau have failed. But progress has been made at state level. Last July, after much prodding, the BLM agreed to suspend the lease sale and allow the governor to conduct a 120-day review of the plan's environmental and economic impact. The advisory report, released late last month, recommends allowing some drilling, but with additional restrictions to protect environmentally sensitive areas.

The chief worry is over wildlife habitat. One of the largest mule-deer herds in North America spends the summer on the plateau—as does Colorado's largest migrating elk herd. It is a favourite place for big-game hunters: 8,000 of them hunted there last year, and recreation generates $5m annually for the local economy. Energy development could change this. Drilling pads and new roads break up habitat. A 2005 study in Wyoming's Sublette county found that drilling there contributed to a 46% decrease in the mule-deer population over four years.

Opening up land for energy development has been a federal priority since 2001. The number of drilling permits granted on federal land in Colorado rose from 79 in 1996 to 650 in 2006. Last year it was closer to 800. Although local oil and gas companies invest an average of $1.6m per well, leasing BLM land for

exploration and drilling rights is cheap. Bidding for a ten-year lease starts at just $2 an acre. Although the governor's compromise for the Roan Plateau seems reasonable to most involved, persuading the BLM to alter its plans will be difficult. In 2004 it rebuffed similar efforts to limit oil and gas development on New Mexico's Otero Mesa. As a result of this, perhaps the best chance to halt the drilling may still lie in congressional action.

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Lexington

Off the leash

Jan 24th 2008
From The Economist print edition

Democratic politics is all about Bill—again

Illustration by Kevin Kallaugher

THE Democrats are in the midst of making an historic choice between nominating their first female presidential candidate or their first black presidential candidate. And who is everybody talking about? A certain 61-year-old white male with a habit of waffling on about the old days, falling asleep in public and turning puce when crossed.

For most ex-presidents retirement is a golden time. They top up their personal fortunes, polish their reputations, perform good works and indulge in their hobbies (skydiving, in the case of George Bush senior). Richard Nixon turned himself into a foreign-policy sage. Jimmy Carter builds houses for the poor. Ronald Reagan wrote movingly about Alzheimer's before the disease silenced him.

For years Bill Clinton trod the same path. The Clinton Global Initiative is widely regarded as a model of its kind. Mr Clinton teamed up with Mr Bush senior to raise money for the victims of the Asian tsunami and Hurricane Katrina. The mere mention of his name was enough to put the devotees of Davos and other such gatherings into a swoon.

But over the past few months Mr Clinton has downgraded himself from global statesman to political hatchet-man. No former president has inserted himself so wholeheartedly into a presidential race. (Mr Bush senior stayed in the background of his son's campaign, and declined to get stuck in even after John McCain won in New Hampshire.) Mr Clinton has not only dismissed Barack Obama as a roll of the dice and a purveyor of fairy tales. He has also ripped into awkward reporters and wandered into the Nevada caucuses to canvass for his wife. He is spending more time campaigning in South Carolina than the candidate herself. Mr Clinton seems intent on playing Spiro Agnew to his wife's Nixon, but with one important difference: Agnew went after the other side.

Mr Clinton's behaviour has caused consternation in the upper ranks of his party. Jonathan Alter reports in *Newsweek* that two leading party figures who are neutral in the race, Ted Kennedy and Rahm Emanuel, have told Mr Clinton to change his tone. Several black leaders have publicly upbraided him.

Some of Mrs Clinton's confidants are also worried that their attack-dog has a touch of the mange. Mr Clinton's stump speeches tend to narcissism—particularly when he is reflecting on his glory years in the

White House. He claims that he never supported the Iraq war, a statement that does not stand up to a couple of minutes' research on the internet. He fell asleep during a service in honour of Martin Luther King at a church in Harlem ("Bill has a dream", quipped the *New York Post*).

Is Mr Clinton damaging his wife's presidential chances as well as his own reputation? This seems unlikely in the short-term battle against Mr Obama. The former president is armed with the biggest megaphone in the business. This could prove particularly important in the battle for mega-states such as California and New York, where advertising is prohibitively expensive and free press is manna from heaven. The Clintons' double-barrelled attack has put Mr Obama on the defensive—not a position that brings out the best in him. It has also succeeded in its chief aim: defining him as a black candidate, and an inexperienced one at that.

But the longer-term effect could be more harmful. The more Mrs Clinton relies on her husband, the more she undermines the most compelling arguments for her candidacy. Take the notion that she is a feminist pioneer. Mr Clinton's omnipresence not only reminds us that his wife made her political career by attaching herself to his coat-tails. Only a spouse could have survived the debacle of "Hillarycare". It also reminds voters that her first instinct when the going gets tough is to turn to her husband.

Or take her claim that she stands for "smart change" or "real change" or whatever the latest slogan is. This was always going to be a difficult pose for Mrs Clinton to maintain. But her hip-and-thigh relationship with her husband underlines her two biggest weaknesses—her scandal-ridden past in the White House (remember Marc Rich? Or the free-loading Rodham brothers?) and the dynastification of American politics. When he retired from the presidency, Mr Clinton left the customary letter to his successor alongside the letter Mr Bush senior had left for him eight years before. Does the world's greatest democracy really want to give Mr Bush a chance to make a similar gesture?

Another rolling disaster?

The biggest damage is to Mrs Clinton's claim that she will be an effective chief executive. Mr Clinton's frenetic role in the campaign surely prefigures the role he will play in the White House, advising here, meddling there, and using the access to top-secret information that his position as an ex-president affords him to second-guess the most sensitive decisions. Who will hold Mr Clinton accountable for his actions? How will the White House function with an ex-president and a vice-president vying for influence? (One insider once termed the "three-headed" relationship between the Clintons and Al Gore a "rolling disaster".) The Clintonians like to describe their bosses as complementary figures who act as "force multipliers". But in the 1990s what actually got multiplied was confusion.

All this will be material for the Republican attack machine. By most reckonings the Republicans should be doomed. But the Clintons' tactics are alienating blacks and young people. The Clintons are in the process of doing the impossible: making the 2008 election a referendum on them, rather than on the Republicans. And the Republicans are inching towards nominating their one candidate, Mr McCain, who has broad popular appeal. If what ought to be a stroll in the park in November becomes a real fight, then the Democrats will know who to blame.

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Canada

The automaton goes on and on

Jan 24th 2008 | OTTAWA
From The Economist print edition

Reuters

In two years in office Stephen Harper has earned respect but not love. Yet Canadians show no sign of tiring of bloodless politics

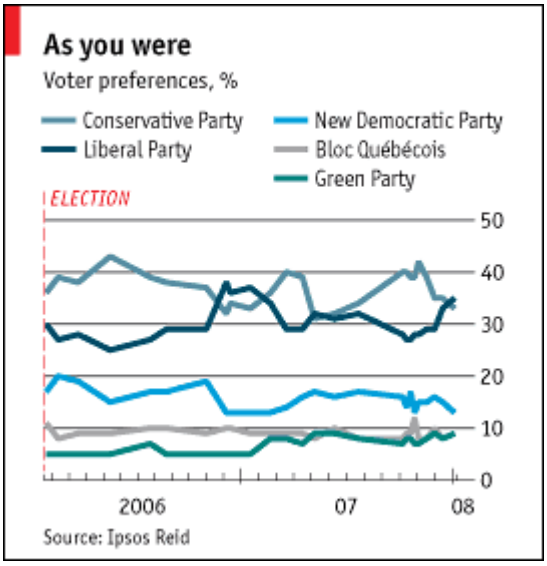
Get article background

MINORITY governments seldom last long in Canada. So when Stephen Harper led his Conservative party to office, but without a parliamentary majority, in a federal election in January 2006, pundits confidently predicted he would soon seek a bigger mandate from the voters. Five fairly straightforward campaign promises were ticked off quickly. But the expected election call never came. Instead Mr Harper pushed through a law fixing parliamentary terms. Unless the opposition gangs up to bring him down, or unless he engineers that outcome himself, his government will soldier on until October 2009—a span exceeded only once before by a minority administration.

That is partly testament to the disarray of a divided opposition. The Liberals, its main element, were leaderless for much of 2006 before picking Stéphane Dion, a mild-mannered policy wonk, who has made a slow start. But Mr Harper has been unable to do much more than survive. Respected for his competence, he has all the charisma of an automaton. “I thought that people needed time to get used to Mr Harper,” says Roger Gibbins of the Canada West Foundation, an Alberta-based think-tank. “But it's turned out that to know Harper is not to love him.” That is especially true for women. Opinion polls show little change in allegiance since the last election—except for a brief moment of Conservative advance last autumn (see chart).

Mr Harper may come to regret not forcing an election then. For the going is getting tougher. His party has not been helped by the raking up of a scandal involving payments in brown envelopes by an arms lobbyist to Brian Mulroney, a former Conservative prime minister, in the 1990s. These claims were revived because the lobbyist, Karlheinz Schreiber, is fighting extradition to Germany, where he faces bribery and fraud charges. Although a tainted witness, he flung enough mud at Mr Mulroney during hearings by a parliamentary committee before Christmas that some of it stuck. Mr Harper felt obliged to promise a public inquiry once the committee has finished its hearings.

Then there are the problems of Canada's ageing nuclear industry. These were highlighted in November when Linda Keen, the head of the nuclear-safety regulator, refused to allow the Chalk River reactor, one of the world's main suppliers of medical isotopes, to restart after routine maintenance because of the failure to install a back-up power system. With customers fearing a shortage of isotopes, parliament passed emergency legislation ordering the reactor to restart without the back-up system. The government then ousted Ms Keen from her post, damaging public confidence in the industry.



Trickier still is Afghanistan, where 77 Canadian troops and a diplomat have died since 2002. Canada's military mission there—it has some 2,500 troops in Kandahar in the south, where insurgents are active—is unpopular, but has been strongly supported by Mr Harper. To defuse criticism, he appointed a non-partisan committee under John Manley, a Liberal former foreign minister, to consider the mission's future. On January 22nd the committee recommended that it continue—but only if reinforced by 1,000 extra troops from another NATO country as well as by more aircraft. Unless Mr Harper secures such support at the NATO summit in Bucharest in April, he could face defeat on the issue in the House of Commons.

By then the economy may have become his biggest problem. Years of strong growth, fuelled by high prices for commodity exports, risk being curtailed by the looming recession in the United States, which takes four-fifths of Canada's exports. The more pessimistic among economists reckon that Canada's fiscal and current-account surpluses could disappear. The Bank of Canada trimmed its benchmark lending rate by 25 basis points to 4% on January 22nd and hinted at further cuts.

Nobody is panicking yet. But slower growth will redouble calls from the premiers of Ontario and Quebec for federal help for manufacturing, which has suffered from the strength of the Canadian dollar. Mr Harper this month announced C$1 billion ($990m) in aid, mainly for one-industry towns where plants close. More schemes like that might win him the extra seats in central Canada that he needs for a parliamentary majority. But he will have less money to play with in the budget, due in late February or early March, and he has already pledged tax cuts.

This year is shaping up to be Mr Harper's most difficult so far. But there is not yet any sign that the opposition will feel sufficiently emboldened to bring him down and trigger an election. Its leaders will be studying the opinion polls as closely as the prime minister. These show that “Canadians are pretty satisfied with the way the world is going,” says Darrell Bricker of Ipsos-Reid, a polling company. Too satisfied, it seems, to want to kick the government out.

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Mexico and NAFTA

Tariffs and tortillas

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Trade is not to blame for the poverty of Mexican farmers

IT WAS in a valley somewhere in central Mexico at least 5,000 years ago that maize (corn, to Americans) was first domesticated. Many Mexicans see the crop as part of their national patrimony, much as potatoes are to Peruvians or pasta is to Italians. So it is understandable that when on January 1st import tariffs on maize (along with beans, sugar and milk) were finally eliminated, many Mexicans felt a twinge of regret. The end of the tariffs marked the culmination of a 14-year transition to free trade between Mexico, the United States and Canada under the North American Free-Trade Agreement (NAFTA).

Few Americans have warmed to NAFTA—Hillary Clinton, whose husband Bill fought for its ratification when president, has promised to review it if she is elected. But only the most ardent anti-globalisation activists would argue that it has not brought benefits to Mexico (and thus to its northern neighbour). Since 1994 Mexico's non-oil exports have grown fourfold, while the stock of foreign direct investment has expanded by 14 times. Even the country's farm exports to its NAFTA partners have risen threefold.

Nevertheless many Mexicans are no more enthusiastic about the treaty than Americans are. Opposition politicians, from both the centre-left Party of the Democratic Revolution and the formerly ruling Institutional Revolutionary Party, argue that NAFTA should be re-negotiated. Peasant farmers are to stage a demonstration in Mexico City on January 31st to which they hope to attract 100,000 people (although, as is customary, many of these will be bused in and paid to attend).

In practice, little changed on January 1st. Tariffs on maize have gradually been dropping since 1994 (when they stood at over 200%). Nearly all maize imports already entered tariff-free under government import quotas. Most of the imports are of yellow corn, used to feed livestock, while Mexico produces mainly white corn. Even so, without cheap imports Mexicans would pay more for their daily tortillas. They were reminded of that a year ago when a temporary shortfall in imports combined with distribution snags to cause the price of tortillas to soar.

Despite the long transition to free trade, little has been done to prepare small-scale farmers. Procampo, a government programme meant to provide a minimum income for every farmer, was hijacked years ago by agribusiness, with a big slice of its annual budget of $1.4 billion going to large-scale farmers in the north. Four-fifths of farmers have fewer than five hectares (12 acres), according to the ministry of agriculture. Most are subsistence farmers who rely on maize—a “recipe for poverty”, according to Luis de la Calle, who was one of Mexico's NAFTA negotiators. The ministry estimates that only 6% of farms are “highly efficient and profitable”.

Nevertheless, the Mexican maize crop has grown from 18m tonnes before NAFTA to 24m tonnes last year. This, says Jaime Serra Puche, the trade minister when NAFTA was negotiated, is a problem rather than a success. Growing maize efficiently requires lots of water, large fields and mechanisation—in other words, Iowa or Saskatchewan rather than Oaxaca. Subsidies have caused Mexican farmers to stick to maize instead of switching to more profitable and labour-intensive crops, such as fruit and vegetables, Mr Serra argues. Alberto Cárdenas, the minister of agriculture, says he is trying to streamline and simplify the subsidy system, and direct more of the money to poorer farmers. Others are sceptical that this is happening.

Advocates for subsistence farmers claim that Grupo Maseca, a big tortilla maker, controls 85% of the market for maize flour. “We are not against markets, we are against monopolies,” says Victor Suárez, one of the organisers of the protest. Mr Cárdenas says that the maize market is competitive, but other officials express worries about market concentration.

Fortunately for the government, the tariffs have been removed while prices are at record levels. With maize at $5 a bushel, thanks to a (subsidised) boom in its use to make ethanol in the United States,

even the least efficient subsistence farmer can make money. Open markets benefit the millions of poor Mexicans who are not farmers but consume lots of maize. But few of them seem to realise this.

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Brazil

Wolf pack

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The survival of patronage politics

Reuters

POLITICS in Brazil, like anywhere else, is mostly about claiming credit for improvements, dodging the blame for disasters and occasionally solving problems. But sometimes it just seems like the easiest route to social advancement. The career of Senator Edison Lobão, pictured with President Luiz Inácio Lula da Silva who named him minister for energy and mining on January 21st, is a case in point.

The job is an important one. Brazil faces roughly a one-in-five chance of black-outs over the next two years, reckons Mario Pereira of PSR, an energy consultancy. The odds turn largely on whether enough rain falls over the next three months in the south-east of the country to fill the reservoirs that feed the hydro plants that provide much of Brazil's power. If not, the government will have to impose rationing.

Enter Senator Lobão. His lack of energy expertise need not be a problem (he has reassured the public that he has been reading about the subject). Nor is it his fault that his surname means “big wolf”—after all, his Christian name is tailor-made for the job. More troubling is his CV, which is not one of steadfast public service. Before becoming a politician, Mr Lobão was a journalist. He wrote such nice things about the generals that ruled Brazil from 1964-85 that they made him a congressman in their tame political party. Plenty of other people worked with the dictators. But Mr Lobão has other blots on his record. He chose his son (inevitably dubbed “little wolf” by the press) as his alternate. He should now inherit daddy's seat—but he is being investigated for tax evasion.

How can someone like Mr Lobão get such an important job? Because he is a protégé of Senator José Sarney, a former president who is a boss of the Party of the Brazilian Democratic Movement, a ragbag outfit that President Lula needs for his majority in Congress. Mr Sarney's influence stems from the grip that he and his family have exercised on the poor, north-eastern state of Maranhão for decades. *O Estado de São Paulo*, a newspaper, recently noted that in Maranhão it is possible to be born, cared for, educated, housed and entertained entirely in public institutions named after members of the Sarney clan.

Mr Sarney was governor of Maranhão under the dictatorship. His daughter, Roseana, was twice elected to the same post. Father and daughter now sit together in the Senate. The family controls *O Estado do Maranhão*, a local newspaper, and, more importantly, the main television and radio stations in the state.

Such feudal political dynasties are less common than they once were in Brazil. In 2006 another legendary political boss, the late Antonio Carlos Magalhães, who dominated the politics of Bahia for half a century, saw his nominee lose the state's governorship. His defeat owed much to Bolsa Família, a programme of cash transfers to poor families from the federal government which Mr Magalhaes was unable to control. But the old ways persist in places like Maranhão. Patronage politics is a heavy burden for Brazil's taxpayers. If the lights go out next year, the cost could get even heavier.

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Argentina

Stop all the clocks

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On Patagonian time

NO FARTHER from the equator than are Los Angeles or Beirut, Buenos Aires is hardly known as a land of midnight sun. But at 10pm in the southern hemisphere summer, it is still not dark in Argentina's capital. For this eerie illumination, *porteños* can thank Cristina Fernández de Kirchner, the country's new president. She decreed that the clocks should go forward by an hour on December 30th for eleven weeks in a desperate attempt to allay energy shortages.

Its geographical position suggests that most of Argentina should be four hours behind Greenwich Mean Time. But it has been only three hours behind for most of the period since 1969, when a military government made summer time last the whole year. Now it is just two hours behind, until mid-March.

The shift is intended to forestall further electricity blackouts—a big power cut left much of Buenos Aires in the dark earlier this month. The cause of the energy shortage is simple: four years of price controls under Ms Fernández's husband, who preceded her in the presidency, have left average energy costs a third below those of neighbouring countries, boosting demand and discouraging investment in supply.

The new time has provoked grumbles in western Argentina, where it remains dark at 7am and clocks now run three hours ahead of Boston, on a similar longitude. “Everyone's complaining about it,” says Mauricio Llaver, a journalist in Mendoza. “You never fall asleep before 1am, and then you wake up exhausted in the morning, and it's still dark outside. One of the pleasures of summer used to be waking up to the songbirds. Not any more.” There is similar grumbling about newly-dark mornings in Patagonia in the south, Ms Fernández's adopted home region. The early signs are that the switch may not save energy.

Ms Fernández is not alone in fiddling with time. Hugo Chávez, Venezuela's populist president with whom she is friendly, decreed last month that his country's clocks should go back by half an hour permanently. The change, aimed at ensuring children go to school in daylight, “affects even the biological functioning of the body,” said Mr Chávez. Maybe, but the result is that Caracas is now two and a half hours behind Mendoza, which is further west. It's enough to make the condors drop out of the sky in confusion.

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Environmental protection in China

Don't drink the water and don't breathe the air

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From The Economist print edition

AFP

And don't expect the government's environmental watchdog to do much about it

THESE days China's environmental bureaucrats know how to talk the talk. They readily admit that pollution is poisoning the country's water resources, air and soil. They acknowledge that carbon emissions are soaring. If only, they lament, the government would give them the means to do something about it.

For all its green promises in recent years, the Communist Party has done little to build a bureaucracy with the clout to enforce environmental edicts and monitor pollution effectively. As long as they deliver economic growth without too much public protest, officials can still expect promotion, however polluted their areas.

Optimists see changes afoot. The State Environmental Protection Administration (SEPA), the government's largely toothless watchdog, could soon be renamed and upgraded to a ministry. Some observers expect the rubber-stamp legislature, the National People's Congress, to endorse the change at its annual session in March.

In an article last year two scholars argued that if SEPA were a ministry it might hold its own better in bureaucratic turf wars in which it is at present “marginalised”. SEPA's weakness was evident last year during one of the country's biggest recent environmental disasters, the choking of the country's third-largest freshwater lake, Taihu, by toxic algae. The contaminants included emissions from small factories and crab farms along the shore. SEPA officials say they could do little: the crab farms fall under the Ministry of Agriculture, waste-water treatment plants under local governments and the lake itself under the Ministry of Water Resources.

SEPA is so weak that its officials admit it has little grasp of the impact of agriculture on water and soil pollution. The Ministry of Agriculture has discouraged it from gathering data even though, as one SEPA official sees it, Chinese agriculture pollutes as much as its industries. The country's first national census of pollution sources is due to begin in February. The ministry is taking part in the two-month effort. But, famously secretive and protective of its bureaucratic territory, it is likely to drag its feet. Health officials would sympathise with SEPA. Their efforts to persuade the agriculture ministry to co-operate over livestock-related threats to public health, such as bird flu, have encountered stubborn resistance. And health already has a full-fledged ministry.

To impress its bureaucratic rivals, SEPA also needs a bigger budget. Officials have said that between

2006 and 2010 China will spend 1.3 trillion yuan ($180 billion) on environmental protection, an increase of more than 85% over the previous five years. But much of this is expected to be given to other agencies (the State Forestry Administration, for example, deals with stemming the spread of deserts) or to the local environmental-protection bureaus, which, being answerable to local governments, are crippled by conflicts of interest.

Little of the money, complains a SEPA official, is used to curb pollution. SEPA itself is so strapped that to finance one of its recent high-profile projects, an effort to calculate a measure of “green GDP” (GDP minus the cost of environmental damage), it begged for money from companies. The government, says an official, gave nothing. After three years of effort, including struggles with a highly sceptical National Bureau of Statistics (NBS), the project was abandoned last year. It did publish one figure: environmental damage in 2004 cost 3.05% of that year's GDP. Last July the head of the NBS said the government had stopped using the term “green GDP” because it was not internationally accepted.

A shortage of money has similarly hobbled SEPA's latest efforts to encourage greener corporate behaviour. These include last year's “green credit” policy whereby state-owned banks are supposed to suspend lending to egregious polluters (SEPA circulated a list of 30 such companies in July). There is also a “green trade ” initiative, announced last October, that threatens polluting companies with suspension of their exports. Also being considered are environmental requirements for companies planning to list their shares publicly, and a tax on polluters. Resistance from local governments and powerful state-owned companies will make it hard to implement such measures.

What it lacks in resources SEPA tries valiantly to regain by appealing to public sentiment. Its deputy director, Pan Yue, is an outspoken green campaigner who happens to be a son-in-law of a famous former general, Liu Huaqing (such connections can be a big help in Chinese politics).

Last year officials reportedly asked the World Bank to remove estimates of pollution-related deaths in China from a report published jointly with SEPA. But SEPA's website still shows a little-reported speech by Mr Pan in 2006 in which he said cancer experts believed that 70% of China's more than 2m annual deaths from the disease were pollution-related. The World Bank had been planning to blame pollution for just 750,000 deaths from various causes.

Chinese officials were worried that the World Bank's figures would cause unrest. But environmental awareness—and anger—is mounting anyway. Of complaints submitted to government departments, 13% relate to pollution, up from fewer than 6% three years ago. And SEPA officials say pollution-related disturbances are also becoming more common—51,000 in 2005 and more than 60,000 in 2006. Such protests are more likely than SEPA's efforts to goad reluctant officials into action.

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Thailand's drug wars

Back on the offensive

Jan 24th 2008 | BANGKOK
From The Economist print edition

The new government is unlikely to offer a ceasefire. A new crackdown looms

NO POLICY pushed by Thaksin Shinawatra, the Thai prime minister toppled in a coup in 2006, provoked as much controversy—or won as many votes—as a bloody 2003 campaign against illegal drugs. Faced with soaring methamphetamine abuse, Mr Thaksin ordered the police to draw up blacklists of suspected traffickers and “to act decisively and without mercy”. The result was a shooting spree in which over 2,500 people died in three months. The police blamed gang violence; human-rights groups accused the government of condoning extra-judicial killings by the security forces.

Five years on, Mr Thaksin's political allies are heading back into power and dusting down their get-tough message. Chalerm Yubamrung, deputy leader of the People's Power Party, which will lead the new government, is widely tipped to be the new interior minister. He has promised another “war on drugs”. This would include mandatory treatment for addicts as well as efforts to staunch the flow of methamphetamine from jungle laboratories in neighbouring Myanmar. On the campaign trail, Mr Chalerm both denied there was any government hand in the previous carnage, and claimed that no “innocent people” were among the victims.

Yet a panel set up last year by the outgoing junta recently concluded the opposite: over half of those killed in 2003 had no links to the drugs trade. The panel blamed the violence on a government “shoot-to-kill” policy based on flawed blacklists. But far from leading to the prosecutions of those involved, its findings have been buried. The outgoing interim prime minister, Surayud Chulanont, took office vowing to right Mr Thaksin's wrongs. Yet this week he said there was insufficient evidence to take legal action over the killings.

It is easy to see why the tide has turned. Sunai Phasuk, a researcher for Human Rights Watch, a lobbying group, says that the panel's original report named the politicians who egged on the gunmen. But after the PPP won last month's elections, those names were omitted. It is a depressing reminder that the law in Thailand can seem at the service of its political masters, rather than the other way around.

On the streets of Khlong Toey, the largest slum in Bangkok, there is nostalgia for Mr Thaksin's iron-fisted drugs policy. The 2003 crackdown drove up prices, smashed trafficking networks and forced addicts into rehabilitation programmes. In drug-ravaged communities, where the ends tend to justify the means, that was enough to turn Mr Thaksin into a hero.

His downfall, and Thailand's political crisis, have sapped police efforts to stop the traffickers. Wanlop Hirikul, a local activist, says that where there was one dealer on the street, now there are three. Supply is plentiful, and in Khlong Toey methamphetamine prices are falling. Drug-treatment centres report rising numbers of addicts. You might expect a military junta with sweeping powers to have kept up the fight against such illicit activity. Anti-narcotics officials say that drug seizures have risen since the military coup in September 2006. Yet that probably means even more of the stuff went unseized.

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Malaysia

Indian mutiny

Jan 24th 2008 | KUALA LUMPUR
From The Economist print edition

A hitherto quiescent minority loses faith in the social contract

AP

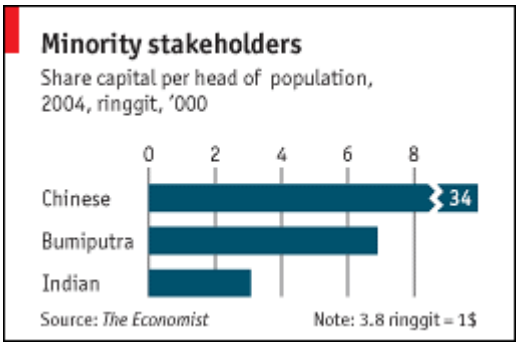
A minority shares its pain

SOME devotees had been fasting for weeks and shaved their heads. The most zealous pierced their cheeks with skewers or attached large wooden icons to their bodies with dozens of flesh-piercing hooks. On January 23rd tens of thousands of ethnic-Indian Malaysians gathered at the Batu Caves temple outside Kuala Lumpur to celebrate Thaipusam, one of Hinduism's biggest festivals. In past years more than a million have turned out. This year, although ministers and pro-government newspapers denied it, the crowd was much thinner. Many Malaysian Indians seemed to have answered a call for a boycott, amid rising anger at the way their minority—around 8% of the country's population—is treated by the government.

Three days earlier the prime minister, Abdullah Badawi, had sought to appease Hindu anger by promising that Thaipusam would henceforth be a public holiday in the capital of the Muslim-majority country. He announced this at a gathering of around 15,000 Malaysian Indians, hoping to show that he still retains their support, despite the emergence in the past year of a radical protest group called the Hindu Rights Action Force, or Hindraf.

Last November Indians gathering at the Batu Caves on the eve of a Hindraf street march were trapped when the temple's managers—said to be linked to the Malaysian Indian Congress (MIC), part of Mr Badawi's ruling coalition—locked the gates and called the police. In the disorder that followed, many were arrested. Even so, the next morning at least 10,000 took part in the Hindraf march, which the police broke up with tear-gas and baton charges.

In the 50 years of peninsular Malaysia's independence from Britain, the ethnic Indians have been more quiescent than the richer, better educated and more assertive ethnic Chinese, who make up about one-quarter of the population. Under an implicit “social contract”, the two minorities, mostly descended from migrant workers, were given citizenship in return for accepting that ethnic Malays and other indigenous groups, together known as *bumiputras* (sons of the soil), would enjoy privileged access to state jobs and education. All the races have done well from strong economic growth since independence. The Indians and Chinese suffer even lower poverty rates than the *bumiputras*. But whereas the majority population have, with official help, started catching up with the Chinese in the property and shares they own, the Indians still have few assets (see chart). Often they are stuck in rented homes and low-skilled urban jobs.



The Indians' sense of missing out on the good life has helped to feed their mood of grievance. But what has most fuelled their anger in the past few years is a feeling that “creeping Islamisation” threatens their religious freedom. The issue that triggered Hindraf's formation, according to N. Surendran, one of the group's leaders, was the demolition of a number of “unauthorised” Hindu temples by local governments, often by state workers who were Malays and thus Muslims. The big rally in November came a few weeks after a temple in Shah Alam, west of the capital, was demolished just before Divali, another important Hindu festival, despite the temple committee's pleas to delay its destruction for a few more days.

Many of the threatened temples were constructed by migrant workers in colonial times, without formal permission, on plantations or by roads and railways built by the migrants. Now this land is being

redeveloped. Hence the drive to demolish them, says A. Vaithilingam of the Malaysia Hindu Sangam, the main association of temples. The authorities could try harder to resolve disputes, he says, but they are too anxious to please rich developers.

The heavy-handed response to Hindraf's protests has served to make things worse. Five Hindraf leaders have been detained without trial under a colonial-era security law, and were said this week to have gone on hunger strike. Hindraf denies the government's charge that it has links to Sri Lanka's rebels, the Liberation Tigers of Tamil Eelam.

With an election expected shortly, Mr Badawi has sought to soothe ethnic Indian anger. Besides declaring Thaipusam a holiday he has promised a cabinet committee to look into poverty among all races. But he may also calculate that the unnecessarily harsh treatment of Hindraf will win his party votes among hardline Malays. If so, he risks helping the extremists on each side peddle the dangerous myth that there is a zero-sum game between the races—and that the way to win it is to take to the streets.

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Whaling

Salty shepherds

Jan 24th 2008 | SYDNEY
From The Economist print edition

A row between Australia and Japan

THE Southern Ocean is usually one of the world's loneliest shipping lanes. This month it has turned into an unseemly battleground over a bid by Australia's government and various environmental groups to stop Japan hunting and slaughtering whales. Japan aims to kill more than 900 minke and 50 fin whales from a region bordering Antarctica by mid-April. It claims the hunt is for scientific research; its critics say this is a brazen front for a commercial whale-meat harvest. As images of the protesters' antics inflame anti-Japanese feeling in Australia, the clash is also threatening the stability of one of Australia's strongest regional ties.

On January 22nd Greenpeace, an environmental-lobbying group, wedged a small inflatable craft between the *Nisshin Maru*, the Japanese fleet's factory ship, and its refuelling vessel. It managed to delay, but not stop, the operation. This was a minor episode compared with a manoeuvre a week earlier by the Sea Shepherd Conservation Society, an anti-whaling body. Two protesters boarded one of the Japanese whaling vessels to deliver a letter demanding that the harpooning stop and, say the Japanese, splashed acid about.

They were detained on the Japanese ship, grabbing headlines worldwide, until an Australian patrol boat returned them to their own ship three days later. More protests seem likely. Paul Watson, captain of the Sea Shepherd ship tracking the whalers, says he is prepared to keep up the chase for weeks. He painted Greenpeace as timid for its failure to prevent refuelling: “Of course it's dangerous. Stopping the whaling fleet is not a game.”

Japanese fleets have been hunting whales in the Southern Ocean for several years. None has had to deal with confrontations like those seen this season. Kevin Rudd, Australia's new prime minister, called for an end to the whaling. An Australian aircraft is keeping an eye on the operation. At least some of the whaling is happening in waters off a section of Antarctica over which Australia claims sovereignty. Eight years ago Australia declared a whale sanctuary in its Antarctic waters.

Humane Society International, another environmental group, won a ruling from the Federal Court in Australia on January 15th that whaling in the sanctuary was illegal and should stop. The court reported Japanese figures showing Japan had killed more than 3,300 minke whales and 13 fin whales in Antarctic waters (not confined to Australia's zone) since 2000.

Mr Rudd's government has reacted cautiously to the ruling. Only France, New Zealand, Norway and Britain recognise Australia' s Antarctic claim. For its part, Japan regards the Australian sanctuary as international waters. Commercial whaling was banned worldwide 22 years ago. But killing for “scientific” research is still allowed under a 1946 convention. Japan's critics question whether research requires so many whales to be killed.

Japanese officials also accuse Australia of hypocrisy: taking the high ground over whales while it kills thousands of kangaroos in controlled culls. Minoru Morimoto, Japan's commissioner to the International Whaling Commission, says: “There are enough whales for those who want to watch them and those who want to eat them.” Derek Luxford, a Sydney shipping lawyer, reckons Australia should resolve the impasse by testing its anti-whaling law before the International Tribunal for the Law of the Sea. The alternative, he says, is to allow “vigilante” groups like Sea Shepherd to enforce its law.

He may be right. The dispute is souring the air as Australia embarks on talks with Japan about a free-trade agreement. And it complicates the Rudd government's bid to balance Japan against China's growing importance for Australia. Mr Rudd, a Mandarin-speaking China expert, opposed a security pact that Australia's former government signed with Japan last year. Japan will be looking for signs that Australia's concern for the future of the whale is not part of some wider agenda.

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Tourism in Nepal

From treks to sex

Jan 24th 2008 | KATHMANDU
From The Economist print edition

Is a new sort of thrill-seeker heading for Nepal?

Get article background

“I CAN only dance when I'm drunk,” confides Srijana, a 20-year-old employee of the Pussy Cat Bar and Shower, a tavern in Thamel, Kathmandu's main tourist hangout. A few slurps from a customer's glass later and she mounts a small stage. There, to whoops from a few tipsy locals, she sheds most of her clothes and gyrates to a Hindi pop tune. Dangling above her is the Damoclean sword included in the bar's name: a silver shower nozzle, positioned to spray flesh-revealing water on a dancer below.

Such gimmicks are common in Thamel's bars, where competition for lascivious males is fierce. Until a few years ago Nepal had no obvious sex industry. There are now an estimated 200 massage parlours and 35 “dance bars”, such as the Pussy Cat, in Thamel alone—with over 1,000 girls and women working in them. Many sell sex. In the Pussy Cat, another dancer admits to turning tricks, for 1,800 rupees ($28).

That is a tidy sum in Nepal, South Asia's poorest country. It is much more than Nepali women are paid in India's flesh-pots—to which over 5,000 are trafficked each year, according to the UN. But the dancers in Thamel are chasing a richer sort of Indian: tourists. And their government seems to be encouraging them. In an advertisement for “Wild Stag Weekends”, the Nepal Tourism Board offers this advice: “Don't forget to have a drink at one of the local dance bars, where beautiful Nepali belles will dance circles around your pals.”

In a country with a rich tradition of dance, where paying for sex is illegal, this might be harmless innuendo. But not everybody thinks so. During the recently-ended civil war, Nepal's Himalayan tourism industry collapsed. Some activists think that sex tourism is replacing it. According to John Frederick, an expert on South Asia's sex trade, “Ten years ago the sex industry was underground in Nepal. Now it's like Bangkok, it's like Phnom Penh.”

The war, which put much of rural Nepal under the control of Maoist insurgents, has increased the supply of sex workers. Srijana is from the poor and still violent district of Siraha in southern Nepal. She was widowed there two years ago, and left an infant son to come to the capital. Yet she is remarkably cheerful—perhaps because she is drunk, and the shower is not working.

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Afghanistan

Paddy re-enlists

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A lot for one man to do

IT IS hard to overstate the hopes being vested in Paddy Ashdown. The former British marine, politician and international proconsul in Bosnia is on the point of being appointed as the new United Nations representative in Afghanistan, charged with steadying nerves and giving direction to the West's faltering stabilisation effort.

The Taliban insurgency has spread from the wild frontier region to engulf much of Afghanistan's southern Pushtun belt, with some exceptions, as well as parts of Pakistan. The traditional winter lull in fighting did not stop a Taliban suicide squad from brazenly blasting and shooting its way into Kabul's poshest hotel on January 14th, killing eight staff and guests.

There is general consensus among Western diplomats and soldiers that, bad as it is, Afghanistan could get a lot worse. Tired of demanding that its European allies send more men and equipment to Afghanistan, America has decided to reinforce its contingent, announcing plans to deploy 3,200 more marines in April. Robert Gates, the defence secretary, also upset the Europeans by suggesting they had yet to master counter-insurgency tactics.

The problem in Afghanistan, however, is more serious than just a shortage of troops. Many of the 39 allies are conducting their own mini-campaigns, frequently in disjointed six-month bursts as fresh units are rotated through a region. They are also pursuing different aid policies.

America, Britain, Canada, Poland and the Netherlands are among those waging the fight in the south, while many others want to stay out of it. America channels its aid through private contractors in the name of avoiding corruption, but Britain gives the bulk of its aid directly to the government to encourage “capacity building”. A recent report by the European Council on Foreign Relations, a think-tank, castigated members of the European Union in scathing terms: “EU countries have treated the common effort in Afghanistan like a pot-luck dinner where every guest is free to bring his own dish.”

In other post-conflict rebuilding efforts, the UN has been given primacy. But in Afghanistan it adopted a low profile as sovereignty was handed over to an Afghan government led by President Hamid Karzai. As security has worsened, the UN and aid charities have found themselves unable to work in many provinces.

For years commanders have looked wistfully at Bosnia, thinking that a “Paddy Ashdown figure” is just what Afghanistan needs. Now, it seems, they will get the genuine article. Lord Ashdown has given warning that “we are losing in Afghanistan” and that defeat here would be worse than in Iraq. But can he turn things around? His appointment is still under negotiation, but it is clear he will not have the powers he enjoyed in Bosnia, where he could sack local officials and rescind laws.

On current plans, Lord Ashdown will replace a German politician, Tom Koenigs, as UN envoy. He will not be, as once mooted, a “triple-hatted” super-envoy who would also represent the EU and the civilian side of NATO. Still, the job that needs to be done is as much a matter of personal dynamism as of formal authority. NATO commanders say they want political direction. As a former member of the special forces, who took part in a successful counter-insurgency campaign in Borneo in the 1960s, Lord Ashdown should have little difficulty in straight-talking with military commanders.

Mr Karzai has often complained that he gets too much contradictory advice from his Western backers. But he is balking at the prospect of a powerful new figure arriving in Kabul, not least because many would like Lord Ashdown to focus on reducing the government's corruption and inefficiency, in a country where opium accounts for about one-third of GDP.

Mr Karzai has demanded clarification of Lord Ashdown's mandate. “We will not be dictated to by anyone,” says his spokesman. Another tricky matter has been America. It provides most of the foreign soldiers, training for Afghan forces and aid. It may not want “co-ordination” by a Briton. For now, though, it seems to accept that the alternative is failure.

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The Gaza Strip

Busting the blockade

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AP

Israel's attempts to squeeze the Gaza Strip are having unintended consequences

UNDER the pressure of Israeli sanctions, Gaza this week blew a gasket. On January 23rd Palestinian militants blasted holes in the metal wall along the sealed Gaza-Egypt border. A bulldozer broadened the gaps. Tens or even hundreds of thousands of Palestinians poured through to buy fuel, food, spare parts and other supplies. Egypt's president, Hosni Mubarak, was annoyed but ordered his troops to let them in, saying they were “starving due to an Israeli siege”. On the Palestinian side, armed men from Hamas, the militant Islamic group that controls Gaza, checked the returning shoppers for contraband and weapons.

The shortages in Gaza have grown gradually worse since Israel, having declared Gaza a “hostile entity”, began restricting imports three months ago in response to a continued rain of Qassam rockets onto nearby Israeli towns. Despite repeated warnings from Israeli human-rights groups that diesel for the strip's only power station was running out, Israel closed the border crossings altogether on January 17th, after a rise in the numbers of Qassams. Three days later the power plant, which supplies around 30% of Gaza's winter-time electricity needs—the rest coming from Israel and Egypt—shut down, leaving large parts of the strip without light, heat or running water.

Israel at first accused Hamas of exacerbating the crisis for political ends, though foreign aid-workers in the territory say Hamas does not interfere with the power station. Israel restored supplies the next day, but said it would keep them to the bare minimum needed to prevent a shutdown. Officials saved face by claiming that Gaza had “got the message”: and, indeed, the Qassam fire did diminish sharply.

Hamas, which an Israeli newspaper reported had planned the border breach months in advance with another militant group, will probably co-operate to reseal the border. It cannot afford to anger Egypt, its only mediator with the West.

But the squeeze on Gaza has led to what Israel wanted to avoid: co-operation between Hamas and its rival party, Fatah. Though Fatah still hates Hamas for ousting it from Gaza in June, the interim Palestinian Authority government in the West Bank appointed by Mahmoud Abbas, the Palestinian president and head of Fatah, has become increasingly anxious to end the blockade. It proposes putting non-partisan forces in charge of the Gaza border crossings, to overcome Israel's refusal to open its side of the crossings so long as the other side is controlled by Hamas. Hamas leaders this week supported the idea, and foreign countries including America, Israel's strongest ally, seem keen too. Such a change, Israel fears, could relieve the pressure on Hamas.

Not that the pressure was working well anyway. Polls show that Hamas's support, which fell after its showdown with Fatah, has stabilised. The Qassams, which rarely kill but keep over 20,000 Israelis living

near Gaza in permanent fear, continue to fall. Israel's collective punishment of the 1.4m Gazans, and its missile attacks on militants that often kill some civilians too (65 Gazans died in the first three weeks of January), merely draw ever louder condemnation at home and abroad.

Yet Ehud Olmert, Israel's prime minister, must feel he has no option. Doing nothing is politically impossible. Negotiating a ceasefire, which Hamas has offered—although there are doubts about whether it can impose one on the other militant groups in Gaza that fire the rockets—would undermine his campaign to unseat Hamas since it was elected two years ago. And a massive army operation to take control of the strip, which some hawks advocate, would mean many deaths on both sides, and could leave the army policing Gaza indefinitely, a resounding failure for Israel's “disengagement” in 2005.

Sanctions on Gaza may not work, but they look tough to the Israeli public, and Mr Olmert needs to look tough. Next week a final report on the 2006 Lebanon war is expected once more to be highly critical of his performance, and political rivals are sniffing blood.

Yet the current policy is self-defeating too. Israel is holding peace talks with Mr Abbas in the hope that Gaza's citizens, seeing real promise of a Palestinian state, will rise up and, if not overthrow Hamas—which says the peace process is worthless—at least make it more conciliatory. But the more Gaza suffers, the harder it is for Mr Abbas to continue those talks. And if a Qassam hits a busy Israeli school playground, Israel's politicians may feel obliged to hit back so hard that they destroy the peace process for good. Israeli and Western policy has been to try to ignore Gaza, but Gaza is showing ever more clearly that it cannot be ignored.

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Kenya

No let-up in the killing

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But perhaps a small breakthrough in the political stand-off

Getty Images

So you want to protest?

A MONTH after its disputed presidential election, Kenya remains deeply divided and unstable. Politically motivated killings, hackings and gang rapes continue in the towns and in volatile country districts. The economy is faltering. The latest bigwig to attempt to mediate between the government of President Mwai Kibaki and the opposition Orange Democratic Movement of Raila Odinga is a former UN secretary-general, Kofi Annan, who arrived in Nairobi on January 22nd. “We have not come with a solution. We are here to insist on a solution,” he announced.

A glimmer of hope for an end to the political impasse appeared on January 24th when Mr Kibaki's government announced it would set up a commission to investigate allegations of vote-rigging, although a surprised opposition said it had not been consulted. Later the same day, however, as *The Economist* went to press, Messrs Kibaki and Odinga were due to meet for the first time since the election. International election observers agree that Mr Kibaki stole the decisive votes to win the election. But Mr Kibaki has since taken a grip on power by appointing loyalists to key ministries.

His strategy is to drag out negotiations long enough for business, faced with mounting losses, to fall in behind him. He also expects many ordinary Kenyans, seeing their jobs disappear, to accept his second five-year term. The Orange strategy is to continue unsettling the markets with calls for mass actions and boycotts of companies in which Mr Kibaki's backers have a stake. Orange leaders hope foreign countries will start applying pressure on Mr Kibaki. They want an interim government overseen by the African Union or another international party, with elections in two years, in which Mr Kibaki would not be allowed to run.

If anything, the mood is getting angrier. The Oranges say they have filed a case with the International Criminal Court accusing the government of crimes against humanity for shooting dead dozens of protesters. The government promises a counter-claim to The Hague, charging Orange leaders with “mass genocide” in the Rift Valley. “Very soon, they as individuals, not as a party, will be languishing in jail,” says a government official.

What has happened is not a genocide, nor is Kenya anywhere close to being a failed state. But the killings and clearances have been grisly and wretched. When the dead rotting in the maize fields or pulled apart in the wilds by hyenas are eventually counted, over 1,000 Kenyans are likely to have been killed since the election. More than 250,000 have been displaced.

Most of the victims have been Kikuyu. But reprisals are likely. The Mungiki, a ferocious Kikuyu gang the

government tried to eliminate with killing squads last year, has already been rehabilitated in some of Nairobi's slums. Some of the killings in the Rift Valley appear to have been premeditated by elders of the Kalenjin, a group of tribes that speak a similar language. Many reckon the chain of command runs all the way to leading Oranges. Elsewhere, the violence has been more spontaneous, with diverse mobs finding common grievance in perceived Kikuyu arrogance and economic domination.

Unfortunately, calls for peace by a multitude of Kenyan groups, including nearly all of the country's business and religious leaders, have been undermined by posturing. The government has used taxpayer money to publish inflammatory newspaper advertisements depicting the Oranges as “warlords of violence” and accusing diplomats of incitement for questioning the election result. And if the government propaganda is meant to stir up fear among Kikuyus, Mr Odinga is hardly making them feel more comfortable. “Our people are being killed like dogs, but no amount of bullets or intimidation will stop us,” he told an emotional rally in Kisumu on January 21st. His people were asking for guns, he said, but he promised them the ballot box. If necessary, Mr Odinga will seek to make his opposition stronghold of western Kenya ungovernable from Nairobi.

There is a chance that Kenya has matured enough to outflank both its demons and its politicians. The Kenyan media council has shown the way by refusing to air inflammatory government radio advertisements. The stakes are high. A complete meltdown in Kenya may set back the entire continent. It would deter investment, distract attention and resources from Darfur and Somalia, and slow down Africa's push for democracy. But it is also a defining moment for Kenya. In the coming months the country may have a chance to break with the worst excesses of corruption, or else slide into even nastier civil conflict.

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Central African Republic

Beyond a failed state

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Will foreign interest help rescue a rotting country at the heart of Africa?

WITH more than its fair share of rebels, refugees and mercenaries, the Central African Republic (CAR) has nonetheless been overshadowed by its bigger neighbours—Chad, Congo and Sudan—whose tribulations have hitherto been much harsher. But the CAR's unhappy turn in the spotlight may come soon. A rebellion in the north has caused a humanitarian crisis. European Union troops under French command, part of a larger EU force to be deployed mainly in Chad, are due to arrive soon to try to prevent violence spreading from Sudan's ravaged western province of Darfur into the CAR.

The new interest has also brought some unflattering scrutiny. The International Crisis Group, a Brussels-based lobby, says that the CAR has dropped below the level even of a failed state. “It has become virtually a phantom state, lacking any meaningful institutional capacity at least since the fall of Emperor [Jean-Bédel] Bokassa in 1979,” it says.

That the self-proclaimed emperor, who was rumoured to eat opponents, is remembered fondly by some people in the CAR shows just how far the country has fallen. When the French, who ran the place until 1960, decided that their long-time protégé had become a liability, they helped to oust him. That did not bring stability. The CAR has suffered no fewer than 11 mutinies or attempted coups in the past decade alone.

The latest man in charge is François Bozizé. He came to power in 2003, backed by Chadian mercenaries, ousting Ange-Félix Patassé, who was supported by Libya and Congolese rebels. Amid the chaos, foreign governments endorsed Mr Bozizé's election victory in 2005, reckoning he was at last someone they could work with.

Since then, however, two more rebellions have erupted. One, in the north-west, pits supporters of Mr Patassé, who is in exile, against the government's feeble forces. Another, in the north-east, has its origins in a combination of ethnic tension and regional neglect made worse by some disgruntled Bozizé men who complain they have not been paid for liberating the country. Thrown into the mix are bandits known as *Zaraguina*, who are mostly from Chad; they loot, kidnap and demand thousands of dollars in ransom for local cattle-herders from the Peuhl tribe.

The result is yet another humanitarian tragedy in a part of Africa already overwhelmed by despair. About a quarter of the country's 4m people have been affected by the violence. The United Nations says some 300,000 have fled their homes. A New York-based lobby group, Human Rights Watch, puts much of the

blame on Mr Bozizé's forces, who, it says, have committed hundreds of murders and burned thousands of homes in a counter-insurgency campaign that started in 2005.

France is still heavily involved; it has supported the government militarily, sending its own men and aircraft to attack the rebels. French advisers working with Mr Bozizé say they have persuaded him to restrain his men. A UN diplomat says the president has begun to pay closer attention to human rights.

Even so, the country remains mired in poverty and neglect. Unions began a series of strikes at the beginning of the year to demand the payment of over seven months of unpaid salaries for civil servants and teachers; the government says it has no money. Foreign aid-workers say that, though international aid to Africa as a whole has soared, the CAR has got even less than before. Some well-wishers hope that the presence of the incoming EU force may help stabilise the country and enable its economy to start growing again.

At least the government is trying to talk to its opponents. “Rebels or *Zaraguinas*, they're just bandits,” says Dieudonné-Stanislas M'Bangot, a presidential adviser. “But we have to negotiate with them, as we don't have the means to fight them. Do you have any better ideas?”

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Nigeria

Democracy by court order

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President Umaru Yar'Adua faces a serious challenge to his legitimacy

AFP

FOR most of Nigeria's post-independence history, its politicians were more wary of losing office by a coup or assassination than by an adverse vote in a free election. These days, it is the courts they are worried about. Election tribunals that were set up to investigate last April's flawed elections have so far ordered six governors, over a dozen senators and scores of local-government officials to leave office for various electoral shenanigans. On January 28th, President Umaru Yar'Adua is due to appear before his own tribunal—and even his ruling party cannot be certain of the outcome.

Since the election, denounced by some outside observers as the most fraudulent they had ever witnessed, over 1,200 petitions have been filed by the losing candidates in protest against the results. Almost all the successful petitions so far have alleged individual breaches of the electoral law, such as ballot papers with missing names. But more systematic crimes may have occurred, and indeed the first petitioner to prove wholesale malpractice on election day—many voters never even saw ballot papers—won his case last week against the governor of Enugu state. Those bringing the case against the president hope to do the same.

The former military president, Muhammadu Buhari, and the former vice-president, Atiku Abubakar, are leading the charge against Mr Yar'Adua—both lost to him in the presidential poll. They allege that the elections were a sham, that the country failed to produce a complete voters' register and that ballots lacked serial numbers (and were therefore impossible to track). Furthermore, Mr Abubakar says he was illegally excluded from the poll until the very last minute, preventing him from campaigning.

Mr Yar'Adua's team dismiss the allegations, and anyway, they say, any irregularities would not have changed the outcome of the election—Messrs Buhari and Abubakar were well beaten by Mr Yar'Adua. And proving that the election was rigged will be no small task. There have been many complaints that obtaining election documents from the government is a bureaucratic nightmare. And the legal requirements to prove rigging have been set high. One senatorial candidate in Taraba state, Rima Shawulu, was advised that he would need 50,000 sworn affidavits to prove that his constituency did not vote for the candidate who was declared the winner.

But the courts still offer hope to those candidates who feel they were cheated. The judiciary is stronger and more independent now than in the past. And even with the blitz of case files, this year's tribunals are moving much faster than those from the disputed election of 2003, some of which dragged on for years. This time the president of the Court of Appeal, Umaru Abdullahi, asked petitioners to “frontload” their cases, revealing their witnesses and evidence before the hearings start. Mr Abdullahi says the courts have also rooted out the corruption that plagued past tribunals. He says he knows the judges are staying clean because he is receiving more official requests for their removal—something past defendants would consider only after bribery had failed.

The good news is that the tribunals show that the rule of law is being taken seriously by Nigeria's institutions. But it is still a very roundabout way to democracy. The tribunal process has been expensive, for candidates and for the country. The National Assembly, where many of the members are preoccupied with fending off tribunal cases, has not passed a single law since it first met last June. And the various annulments so far have had little deterrent effect; local elections across Nigeria's states in the past several months have been violent and of dubious credibility.

Regardless of the first verdict in Mr Yar'Adua's case, it will no doubt be referred up to the Supreme Court. Many wonder if the judges will want to go down in history as affirming an election that almost everyone considers a sham. As one Court of Appeal judge, Helen Moronkeji, put it in a recent election case, “Democracy is not an esoteric or fanciful concept too difficult to grasp.” In Nigeria, it is the judiciary, rather than the politicians, who seem to understand this.

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Spain

Zapatero's bear fight

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The Spanish prime minister must win an unexpected new battle if he is to be re-elected in March

Illustration by Peter Schrank

THE surprise ingredient in the Spanish election of March 2004 was the Madrid train bombings, which killed 191 commuters just three days before the vote. Thanks to the clumsiness of the outgoing People's Party (PP) government, which tried to blame Basque terrorists, not Islamist radicals, the bombs provoked an unexpected change. What had looked like a PP shoo-in turned into a Socialist bounce-back, handing victory to José Luis Rodríguez Zapatero, now Spain's prime minister.

Four years on, Mr Zapatero is seeking re-election. This time, too, a surprise ingredient has arrived ahead of the March 9th poll. But, despite the recent arrest in Barcelona of 14 Muslim immigrants suspected of planning fresh attacks, it has nothing to do with Islam. After four years in which Spain's politicians have argued bitterly about almost everything else, the new ingredient is the economy.

Few would have predicted this even six months ago. An economy growing at a healthy lick of 3.8% seemed to be one of the strongest of Mr Zapatero's weapons. But since then Spain's housing bubble has burst and inflation has risen. Global financial turmoil now threatens to turn a hoped-for soft landing into something much harder. And the PP, seeking to avenge its 2004 loss, smells blood.

For voters who were not already worried, this week's stockmarket panic was a rude awakening. Few Spaniards are feeling the pain yet, but many expect to. A weekend poll showed three pessimists for every two who are optimistic about the economy, a sharp reversal from July. The political question is whether voters will punish Mr Zapatero for their gnawing sense of uncertainty, or prefer him as the man to lead them through hard times.

His opponents are in no doubt. “The government thought this was their strong point,” comments Alvaro Nadal, the PP's employment spokesman. “The economy had little impact for several years. Now it is very important.” The burst housing bubble is already slowing growth in a country heavily dependent on construction. Unemployment began to rise in 2007 for the first time in four years.

So far, though, nobody is talking of recession. The government predicts 3.1% growth in 2008 (*The Economist*'s consensus forecast is 2.4%). Mr Zapatero claims that the budget surplus has reached a record-breaking 2% of GDP. A surge in the workforce, mainly from immigration, has swollen the coffers of a social-security system that has gained 2.7m more contributors. The government thinks it has a large

fighting fund to spend its way out of trouble, if it needs to. “We must wait and see,” says the Socialists' chief economist, Inmaculada Rodríguez-Piñero. Even the PP sees room for early tax cuts.

If the polls of voting intentions are at all reliable, Spaniards are slowly but surely drifting away from Mr Zapatero. A Socialist lead of five points in 2004 is down to only two in some polls. It is no surprise to find that many Socialists wish they had fought the election last year, before the world economy wobbled. They have watched in dismay as fast-growing GDP in the past three years has been matched by fast-growing economic pessimism. Indeed, Mr Zapatero has performed a kind of reverse alchemy, transforming economic gold into political lead.

With the economy now weighing so heavily, two unlikely campaign champions have emerged. On one side is the solid, if unglamorous, figure of Pedro Solbes, the finance minister. Mr Zapatero is pushing this former European commissioner as the safe pair of hands that Spain needs. “He was born to do this,” he said, when Mr Solbes agreed to stay on after the election.

On the PP side is Manuel Pizarro, best known until recently as a former president of Endesa, an electricity utility. He endured much government meddling in a takeover battle that raged for most of the past four years. Now the party leader, Mariano Rajoy, has hired him. Some say he could be the PP finance minister. Mr Pizarro, a forthright liberal, has the charisma that Mr Solbes lacks. But he is also a political novice. A proposed debate between the two men is being billed as the big event of the campaign. Mr Solbes wants to help his opponent to “clarify some ideas.” Mr Pizarro retorts: “Bring them all on.”

Yet the PP has a mountain to climb to get near the Socialists. The opinion polls point to a narrowing gap, but not yet to a PP win. Mr Zapatero has much higher personal ratings than Mr Rajoy, and Mr Solbes is one of his more popular ministers. And the PP has done far too little to woo key voters in the political centre. Mr Rajoy treats global warming as a joke. His party backed the unpopular Iraq war. Social and religious conservatives have become increasingly visible within the party, protesting against Socialist laws to bring in gay marriage and quick divorces or to take religion out of the core school curriculum. Angry debates over the government's attempted peace deal with ETA, the Basque terrorist group, and its granting of more powers to Catalonia have pulled some voters into the PP camp. But the furiously nationalistic tone that the party has employed has put others off.

Nor has the treatment of one leading PP centrist, Alberto Ruiz-Gallardón, a popular mayor of Madrid, helped. Mr Ruiz-Gallardón was kept off the party's list mainly to make room for Mr Pizarro. Some see this as part of the jockeying for the party leadership if Mr Rajoy loses the election and is forced to quit. Mr Rajoy was hand-picked as leader by the previous PP prime minister, José María Aznar, who stepped down in 2004 because he had pledged to serve no more than two terms in office. Critics say Mr Rajoy lacks the strength of a candidate who has had to fight to the top.

All this, however, may weigh less heavily on voters' minds on March 9th than the economy. Spain is staging what amounts to the rich world's first big post-credit-crunch election. Politicians heading for the polls in other countries that are feeling the fall-out from global financial turmoil are watching carefully.

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Italy's rocky government

On its way out

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Romano Prodi's centre-left government seems to be out of time

ONE conservative senator, in hospital for surgery, planned to come 580km (360 miles) by ambulance to vote. Italy's political crises are nothing if not melodramatic. But this week's was building to an exceptionally tense climax. On January 23rd the Chamber of Deputies passed a motion of confidence in Romano Prodi's 20-month-old centre-left government. A day later, as *The Economist* went to press, he faced a far tougher test in the Senate. As one ally after another peeled away from his coalition, he was under pressure to resign rather than be defeated.

Mr Prodi's government was pitched into crisis by the departure from his coalition of Clemente Mastella, the justice minister, along with his tiny party, the Udeur. Without the votes of the Udeur's three senators, Mr Prodi no longer enjoyed a majority of the Senate's elected members. Two senators from a small liberal party led by Lamberto Dini then withdrew their support, as did a maverick right-winger. Mr Prodi's dimming hopes of survival rested on seven unelected life members—and his prospect of seducing opposition senators with special favours.

Italians usually take their politics with equal doses of humour and cynicism. What is striking about the latest parliamentary manoeuvres is that they are being played out against a background of popular fury and shame. Last month's news that by some measures Italy's GDP per head had been surpassed by Spain's was a big shock. Then came a deeply embarrassing Naples garbage crisis. And all this at a time when wage-earners are suffering under stiff tax rises.

Many politicians seem oddly unaware of the extent of public anger. Addressing the lower house this week, Mr Prodi sounded like the leader of a government with solid backing, not one who the polls suggest has an approval rating of just 31%. It was left to the head of the Italian Catholic bishops, Cardinal Angelo Bagnasco, to voice public alarm. He spoke in apocalyptic terms of a divided nation, bereft of hope.

His speech also stirred suspicions of a Vatican hand in Italy's political troubles. Catholic leaders are pressing for changes to Italy's 1978 abortion law that they know most of the centre-left would resist. Just before the latest political crisis blew up, they were at loggerheads with the government over an incident in which Pope Benedict pulled out of a visit to La Sapienza university in Rome, after protests by a minority of students and academics. The Vatican claimed (though the government denied) that the authorities had been unable to guarantee the pope's protection.

Mr Mastella is a Christian Democrat with close links to the Vatican. But he had reasons of his own for abandoning the centre-left. His tiny party could be swept from parliament by the electoral reforms backed by the main centre-left group, the Democratic Party. And on January 16th Mr Mastella quit the cabinet after he, his wife and several leading members of his party became suspects in a corruption investigation. All deny wrongdoing; and Mr Prodi went as far as he could in the Chamber of Deputies to assure Mr Mastella of his continuing support.

Yet the ex-minister must feel his chances of returning to office may be better in a centre-right government led, once again, by Silvio Berlusconi. If Mr Prodi falls, and unless a cross-party technocratic government is then formed, that will be the less-than-appealing alternative before Italy's angry voters.

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Italian art treasures

Coming home

Jan 24th 2008 | ROME
From The Economist print edition

Italy wins back some smuggled classical art treasures

AP

IT IS a treasure hunt with a difference: conducted not with metal detectors, but by negotiation. Italy is at last reaping the benefits of a two-year campaign to regain smuggled antiquities. Five American museums have been cajoled into returning works that they claim to have acquired in good faith. Almost 70 of the finest are now on display in Rome—and they have just been joined by the only known intact work by Euphronios, an Athenian vase-painter (pictured).

New ground is also being broken with the return of nine items from the private collection of a New York philanthropist, Shelby White. This is the first pact negotiated with an individual. Francesco Rutelli, the culture minister, met Ms White twice in America before the deal was done. She has always maintained that she and her late husband, Leon Levy, had no idea that the pieces were suspect. A tenth item from their collection, also by Euphronios, is being sent back to Italy in 2010.

Under Italian law, any classical artefacts found on Italian soil belong to the state, even if (like Euphronios's vases) they originated in Greece. A former curator of the J. Paul Getty Museum in Los Angeles and an American art dealer have been on trial for almost three years in Rome, charged with trafficking in illegally excavated objects. Both deny wrongdoing. Their indictment was followed by a deal that officials say is crucial for efforts to curb the traffic in contraband antiquities: Switzerland has undertaken to require importers of classical artefacts to produce proofs of origin and of legal export.

The deals with the museums have all involved give-and-take. In exchange for works claimed by Italy, the museums have been given others on long-term loan. “Italian lovers of art and archaeology will get back what has been stolen, while others abroad will profit from the exhibition of sometimes even more beautiful works,” says Mr Rutelli.

The deal with the Getty museum was the hardest to do but also the most productive: 40 of the works on show in Rome come from there. But they do not include the “Getty bronze”, which the Italians had hoped to retrieve. This third-century BC statue, attributed to Lysippos, was caught by Italian fishermen in 1964. The Getty insists that it was found in international waters. The Italians say it was still illegally exported. An Italian court has found for the Americans.

The restitution of the treasures will also bring to an end a 1,872-year marital rift. One piece on show is a statue from 136 AD of the Emperor Hadrian's wife, Vibia Sabina. It will now be put alongside her husband's statue at his villa in Tivoli. Too bad the pair had one of ancient Rome's most disastrous marriages.

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Eastern Europe, America and Russia

Pipedreams

Jan 24th 2008 | VILNIUS
From The Economist print edition

America seems to care more than the European Union about eastern Europe

Get article background

EUROPEANS may not always like it, but America still matters most for their security. As Kosovo edges towards independence, NATO ponders further expansion and Russia rips Europe's threadbare energy policy to rags, every debate involves America. And the mood is gloomy.

“Russia is getting stronger; we are getting weaker”, concludes one European political leader. That is alarmingly clear in Serbia, where a pro-Russian nationalist, Tomislav Nikolic, came out ahead in the first round of the presidential election on January 20th. Serbia has just signed an energy pact to distribute Russian gas exports to Europe; in return a Russian company (the oil arm of Gazprom, the state-run gas giant) is to get a controlling share in Serbia's national oil monopoly.

Europeans flinch at the idea of Kosovo, the mostly ethnic-Albanian province of Serbia, declaring independence immediately—something the Russians strongly oppose. The Americans fear that more delay risks violence by impatient Kosovars or by Serb provocateurs. Some Europeans plead for a few weeks longer, perhaps to allow yet more talks with Serbia after its presidential election, or simply to get more European waverers such as Spain and Romania to back European Union recognition of an independent Kosovo.

Serbia is one of what some analysts call “swing states”, places where Russia and the West are vying for influence. Others include Ukraine, Georgia, Azerbaijan and Moldova—and even a few EU members such as Latvia and Bulgaria. President Vladimir Putin of Russia, accompanied by his likely successor, Dmitry Medvedev, recently signed a deal with Bulgaria to build a new pipeline across the Black Sea. Called South Stream, this will pipe Russian gas direct to Europe, bypassing transit countries such as Ukraine and Poland. In this, it matches Nord Stream, a similar bypass under the Baltic (see map).

South Stream may stymie a rival EU effort, Nabucco, which was meant to bring gas from the Caspian and Central Asia to western Europe through the Balkans. Nabucco would be the only pipeline from the region not to cross Russian territory, giving Europe the hope of more diversified gas supplies. Nabucco's prospects already looked shaky: gas for it must come from either a trans-Caspian pipeline (which Russia

has blocked) or Iran (which America dislikes). If South Stream were built, it would make Nabucco uneconomic.

Pipelines and dependence on Russian gas are not the only sources of controversy. American and European diplomats are also wrestling with the question of NATO expansion, which may feature at the alliance's summit in Bucharest in April. The leading candidate is Croatia. Albania and Macedonia are less prepared, but bringing them in might be seen as one way of countering instability caused by Serbia's hostility to Kosovo's independence.

That leaves Ukraine, whose new government says it wants eventually to join NATO, and Georgia, which tarnished its democratic credentials in a crackdown on opposition protests in November. Offering either country a membership action plan—a staging post to joining the alliance—would enrage Russia. But holding back might be seen as giving the Kremlin a veto over its neighbours' security arrangements. The hunt is on for something else to offer instead.

Largely silent is the EU, whose members appear more concerned over institutional reform and emissions targets (see article) than geopolitical issues. That worries the Americans. They seem to have settled a row with Poland over a planned missile-defence base. But not much else is going right. Ron Asmus, a former American diplomat now at the German Marshall Fund, a think-tank, frets publicly about a “rollback” of the West's influence in eastern Europe. He is not the only one.

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European energy

Hot air

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The start of big arguments over Europe's emissions targets

THE European Union revealed on January 23rd how it plans to save the world. A mammoth climate-change plan spells out in detail how much pain each of its 27 members will have to bear if the EU is to meet ambitious targets set by national leaders last March.

The aim is to cut greenhouse-gas emissions by 2020 by at least a fifth, and more than double to 20% the amount of energy produced from renewable sources such as wind or wave power. If fuel from plants proves green enough, 10% of the fuel used in transport must come from biofuels by the same date. The new plan turns these goals into national targets. Cue much grumbling, and no doubt months of horse-trading, as the European Commission's recommendations are turned into binding law by national governments and the European Parliament.

Countries with greenery in their veins are being asked to take more of the burden than newer members. Sweden, for example, is being invited to meet 49% of its energy from renewables. At the other end, Malta gets a renewables target of just 10%. It is a similar story when it comes to cutting greenhouse gases: by 2020, Denmark must cut emissions by 20% from 2005 levels; Bulgaria and Romania, the newest members, may let their emissions rise by 20%.

EU leadership on climate change will not come cheap. The direct costs alone may be €60 billion ($87 billion), or about 0.5% of total EU GDP, by 2020, said the commission's president, José Manuel Barroso. But this is still presented as a bargain compared with the cost of inaction, which Mr Barroso put at ten times as high. Oh, and leading the world in the fight against climate change need not cost jobs, even in the most heavily polluting branches of heavy industry. “We want to keep our industry in Europe,” insisted Mr Barroso.

The trick to squaring that circle is the EU's emissions-trading scheme (ETS). This obliges big polluters such as power companies or manufacturing giants to trade permits that allow them to emit CO_2 and other climate-change nasties, within a steadily tightening overall cap. If countries such as the United States and China do not sign up to binding international agreements by 2011, then the heaviest greenhouse-gas emitters inside the EU may be given these allowances free, the commission suggests. Or, it threatens, firms outside the EU could be forced to buy ETS permits. They won't like that.

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French reforms

Attali the Hun

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A brave agenda for reform, but will it ever be implemented?

MANY a tree has been felled in the cause of diagnosing the ills of France's economy, and prescribing a cure. Indeed, France excels in both producing and ignoring official reports. Two years ago, Michel Pébereau, chairman of BNP Paribas, wrote one on how to cure the French addiction to public spending. A year before that, Michel Camdessus, a former IMF boss, penned another on how to boost economic growth. The then finance minister, Nicolas Sarkozy, called the Camdessus report his "bedside reading".

Yet few ideas in either of these earlier reports were turned into policy. Now, France is again chewing over the advice of an economic commission. Published on January 23rd, this report was requested by President Sarkozy, and written by a commission headed by Jacques Attali, once right-hand man to François Mitterrand, a former Socialist president. Like the others, it is an excellent handbook for the radical overhaul of the economy. But will it, like them, also end up on the shelf?

Many proposals in the Attali report, entitled "300 Decisions for Changing France", are not new, but they are still brave. They include the deregulation of "restricted professions", such as pharmacists and taxi drivers, and the abolition of a law banning hypermarkets from selling at below cost. Others are already government policy, like the creation of ten super-universities. Others still are more novel, such as the elimination of *départements*, the administrative layer between town councils and regions, the creation of ten ecological new towns and the teaching of economics in primary schools. While urging compensation for losers, the report adds up to a sweeping liberalisation of the economy. "The French need in particular to know that the future of work is no longer in the public sector," it says, "and that of companies is no longer in subsidies."

Mr Attali calculates that, if adopted, his plans could boost annual GDP growth by one percentage point, cut unemployment from 8% to 5%, reduce the numbers living in poverty from 7m to 3m and take public debt down from 64% to 55% of GDP. But, as he also makes clear, to achieve this, his measures must be adopted wholesale, not *à la carte*. He even includes a timetable: approval by April, implementation between then and June 2009.

AP

A bit too bold, Jacques

When he appointed him, Mr Sarkozy promised Mr Attali that "whatever you propose, we will do". The report quotes this phrase on its opening page. Yet, although Mr Sarkozy said this week that he agreed with "the bulk" of the proposals, he explicitly ruled out some, such as the abolition of the *départements*. He also argued that deregulating pharmacies could deprive people of "a public service".

Despite Mr Sarkozy's campaign talk of a *rupture* with the past, on almost every measure, from the reform of universities to pensions to the labour market, his reforms in office have turned out to be half-hearted. For example, the new job contract just agreed by the unions and employers after months of negotiation will enable employers to shed workers without the risk of going to a labour tribunal, but only at the price of higher pay-offs. Eric Chaney, chief European economist at Morgan Stanley, terms this a "homeopathic" remedy.

It could be that Mr Sarkozy now plans to use the half-reforms that he is implementing as stepping-stones to something bolder. It could also be that he hopes to use the Attali report, written by a one-time man of the left for a president of the right, to find a new consensus for pressing ahead more forcefully. Past experience with such reports, however, is not encouraging. As Mr Pébereau put it wearily in his report in 2005, "the multiplication of commissions, committees and reviews contrasts with the feeble use made of their work. Their creation even sometimes seems to be a way of putting off decisions."

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Charlemagne

The in and out club

Jan 24th 2008
From The Economist print edition

The dangerous appeal of a semi-detached status for Britain

Illustration by Peter Schrank

FEW documents in the long and weary history of Britain's on-off involvement with the European project have inspired more bad faith than the Lisbon treaty, now trundling slowly towards ratification. In the House of Commons, debate on it began this week, prompting much interest and exaggerated nervousness in Brussels. Insults are flying, as all sides accuse each other of lying about the treaty, its implications and their motives for supporting it, opposing it or calling for a referendum.

In one respect only is there a hint of consensus between Eurosceptics and federalists. Voices can be heard on both sides calling for Britain to move to the margins of the European Union. Eurosceptics dream of aping Switzerland and Norway, which enjoy access to the single EU market through the European Free Trade Association (EFTA) and bilateral pacts, but keep control over foreign policy, farms and other touchstones of sovereignty (they also pay less into EU coffers). Eurograndees dream that, if Britain would only shift aside rather than acting as a constant brake on integration, federal union might come sooner.

At the risk of being difficult, Charlemagne offers this thought: the accusations of bad faith are justified, and admitting this would be healthy; but it is unhealthy nonsense to think that anybody would gain from a semi-detached Britain. Start with the bad faith. For British critics, the treaty is a bid to bamboozle voters, and smuggle into law most of the failed EU constitution (rejected in French and Dutch referendums in 2005). This is correct—as many European politicians have noted. As the British debate began, critics demanded to know why Lisbon did not merit the referendum promised on the constitution (see article). One Tory asked if the government thought the British public “too thick to understand its benefits”. Or did ministers fear being “rumbled”, he wondered, for giving away powers to the EU?

Much of the Brussels establishment would answer “yes” to both questions. They see British voters as exceptionally ignorant; or, to be more charitable, they think the British debate is poisoned by nationalism, fomented by scare stories in the British press. Brussels takes as given the cowardice of the British government when it comes to making the case for Europe. Those working to avoid popular votes on the treaty justify their actions on the ground that Eurosceptics are acting in still worse faith. British Eurosceptics are assumed to want a referendum only because it would be lost, condemning the EU to more years of institutional wrangling. In many cases, this assumption is correct.

From the other side, the British government is accused of breaking its word by rejecting a referendum. This too is true. Even Europhiles wince as ministers struggle to justify their about-turn. They offer a

different root cause for the government's contortions: they blame Tony Blair, the former prime minister, for offering a referendum on the constitution in the first place. In other capitals, there is special rancour that the British secured hefty opt-outs from the constitution and came back for more in the Lisbon treaty—and still grumble about the results.

No EU leader has yet called for Britain's expulsion. But the idea is gaining currency that Britain may be an intolerable obstacle to European unity. At the right Brussels dinners, speakers of a certain grandeur (an ex-commissioner, say, or a bigwig from the European Parliament) win table-thumping applause by denouncing perfidious Albion, before noting solemnly that the Lisbon treaty, for the first time, allows countries to get out. Valéry Giscard d'Estaing, a former French president and head of the convention that drafted the constitution, has declared that any country that fails to ratify the Lisbon treaty should seek a special status within the EU, or leave. Only Britain faces that possibility, he added, to avoid any possible doubts.

Such reveries ignore the fact that the EU is, first and foremost, an economic project. And that, when it comes to economic nationalism, there are many worse offenders than Britain (France, for one). Britain may be sulky, but it preaches economic liberalisation; when it accepts the logic of a supranational project such as the single market, it is then a stickler for the rules. Indeed, Britain's absence from the European top table is more likely to increase nationalism within the EU than to decrease it.

The Swiss-Norwegian lure

A semi-detached status has a different resonance for British Eurosceptics. Mention Switzerland and Norway, and they go misty-eyed. Britain is an ancient maritime, mercantile power, it is argued. The salt tang of the ocean is in the blood, with a yearning to roam the world unfettered by continental sloth and red tape. There is just one problem: Britain is not Norway or Switzerland.

EFTA countries have access to the EU market on relatively generous terms. You can quibble about whether the deal is as good as it looks (members have no influence over EU rules, but must obey them anyway). But that argument has limited weight with British Eurosceptics, who say their country enjoys minimal influence now. So try a simpler line. The EFTA countries are small, making concessions to them pretty painless. And they may be tempted to join the EU one day, making it worthwhile to offer them sweeteners. If Britain left the EU, the 26 other countries would set terms for free access to their market (including a big contribution to their budget). They would have no interest in offering a sweet deal: as any member of a book club can attest, the free dictionary is offered on the way in, not on the way out. Britain would remain just as vulnerable to EU calls for harmonised working hours, or tax rates, if not more so. As an ambassador predicts, “Britain would have to pay a very high price.”

In short, Britain might enjoy less not more trade freedom if it pulled half out of the EU, as protectionist governments flexed their muscles and allowed nationalism to tarnish the project. Anyone who dreams otherwise is lying not just to others, but also to themselves—the worst bad faith of all.

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Economic nerves

Nothing to smile about

Jan 24th 2008
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The prime minister faces a deteriorating economic outlook

Reuters

DURING his decade-long stint as chancellor of the exchequer, Gordon Brown relished one achievement above all others. That was his record in delivering economic stability, not just by keeping inflation down but also by maintaining growth. Towards the end of his time at the Treasury, Mr Brown even asserted that Britain was enjoying its longest period of sustained growth for centuries. The historical figures had to be tortured to buttress this claim, but the prime minister remains inordinately proud of his success as chancellor. He told MPs on January 23rd that Britain's economic stability was acknowledged around the world.

The trouble is that Britain's record as a financial regulator was also once greatly admired—before Northern Rock blew that reputation apart. Mr Brown has spent much time recently finding ingenious ways to avoid the political embarrassment of taking the stricken mortgage lender into formal public ownership. Yet if the economy slips badly, the prime minister will find that a far more serious mishap than nationalising Northern Rock.

The dangers of an economic reverse appear to be mounting. Mervyn King, the governor of the Bank of England, struck a sombre note on January 22nd when he addressed a group of businessmen in Bristol. “To put it bluntly,” the central banker said, “this year we are probably facing a period of above-target inflation and a marked slowing of growth.”

Tempering this bleak message, official statistics published this week showed that the economy was still growing respectably in the final three months of 2007. GDP expanded at a quarterly rate of 0.6%, more or less in line with trend growth and only a little less than in the previous quarter, when it increased by 0.7%. The latest labour-market figures have also been encouraging. Employment jumped by 175,000 in the most recent three months (to November) compared with the previous quarter, and the jobless rate fell.

Yet economic momentum is quickly dissipated if it meets strong-enough counterforces. Worryingly, these have now emerged and appear to be gaining in strength. For one thing, as America's woes intensify, Britain is bound to start feeling some of the pain. Historically the two countries' business cycles have tended to move together, not only through trade flows but also because of especially strong financial and investment links.

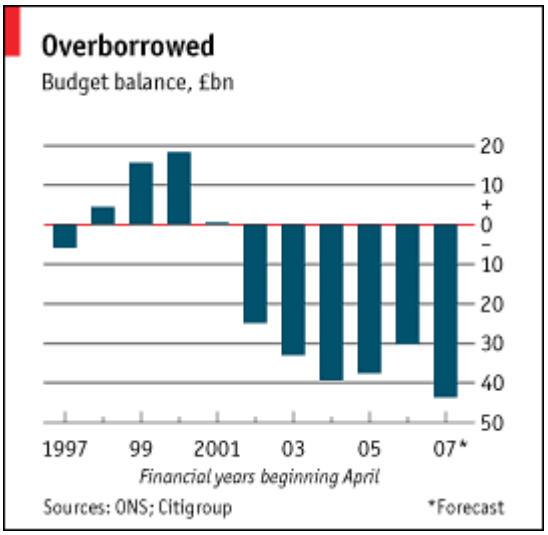
More important, Britain will be hit hard by the credit crunch. Conditions in money markets have eased a lot since the end of last year, thanks to central banks' decision in December to pump cash into them. The

benchmark three-month rate at which banks borrow from one another has fallen sharply over the past month. But the financial crisis remains grave and is increasingly affecting the wider economy. Lenders slashed the amount of credit they were prepared to make available late last year, and they intend restricting it again in the first quarter of 2008.

The housing market is already wilting, as banks tighten the terms on which they make mortgage loans and would-be buyers take fright at the possibility of instant losses on their purchases. That augurs ill for consumer spending, which has been buoyed over the past couple of years by another bout of rapid house-price inflation. Rising housing wealth has offset a dismal period for living standards as, despite a strong economy, rising inflation, taxes and interest payments have eroded growth in real disposable incomes. Now this prop is about to be removed.

Indeed, the first signs of a consumer slowdown are already apparent. Official figures for retail sales in December were weak, contributing to the falling prices of retailers' shares earlier this month. As consumers grow more cautious about spending and borrowing, it seems unlikely that other sources of demand will come to the rescue. The euro area, Britain's main export market, will itself be slowing. Businesses will be in no mood to invest in a weakening economy, and will in any case be constrained by tighter credit.

If the economy is to make way against these counterforces, it needs either a budgetary or a monetary stimulus. Mr Brown was lucky that the last global downturn, precipitated by the dotcom crash, coincided with a surge in public spending that had, handily, already been planned. But after that he failed to put the public finances in order, and the latest figures tell a sorry tale (see chart). The budget deficit looks set to widen to £43 billion ($84 billion) in 2007-08, according to Citigroup, a bank. Mr Brown's imprudence has left his chancellor, Alistair Darling, with little scope to provide a fiscal boost.



That leaves monetary policy. The Bank of England cut the base rate from 5.75% to 5.5% in December. But earlier this month only one of the nine-strong monetary-policy committee backed another quarter-point cut. Mr King hinted in his speech this week that a cut was on its way next month when he said that the current base rate was “probably bearing down on demand”. The governor also stressed pointedly, however, the risk that inflation will rise this year—not least because of the recent sharp fall in sterling's exchange rate, which will push up import prices.

It was Mr Brown who gave the Bank of England freedom to set interest rates in order to meet an inflation target. Now that same independent central bank is grappling with an ugly conjuncture of rising inflation and falling growth. The prime minister must be praying that Mr King and his fellow rate-setters make the right call. His political future as well as his economic reputation may depend upon it.

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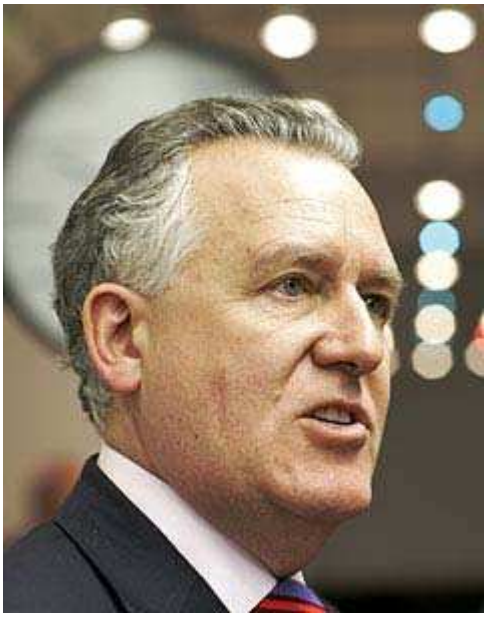
Political-party funding

Hain walks the plank

Jan 24th 2008
From The Economist print edition

An embattled minister finally quits

Barcroft Media



Hain resigns to “clear his name”

WHICH is a worse ministerial sin, corruption or incompetence? Defending Peter Hain—now the ex-work and pensions and Welsh secretary—against calls for his head, Gordon Brown implied that the latter was a lesser and forgivable evil. Mr Hain's late declaration of £103,000 ($200,500) that he raised to fund his failed bid for Labour's deputy leadership, said Mr Brown, was merely “an incompetence” that did not negate Mr Hain's ministerial virtues. It was at best an unconvincing defence, and, as it turns out, a temporary one. On January 24th, after the Electoral Commission referred his case to the Metropolitan Police, Mr Hain telephoned the prime minister and resigned.

He had tried to downplay his sloppy accounting—the full extent of which emerged only this month—as an oversight. But his position was weakened by the fact that some of the money had been channelled through a dodgy “think-tank”, and by his own failure to answer the resulting questions fully.

On the face of it, it was odd, perhaps, that the prime minister hung on to Mr Hain for so long. Raised in South Africa and an erstwhile campaigner against apartheid, Mr Hain is a former Liberal who has never been widely loved in the Labour Party. But other considerations influenced Mr Brown's loyalty. This is the first cabinet minister he has lost—never a happy moment for a prime minister. Perhaps more importantly, the furore over Mr Hain emerged in the wake of wider unhappiness over mysterious donations to the Labour party. “Resigning” Mr Hain might have increased the pressure on two other Labour figures with murky finances: Harriet Harman, who beat Mr Hain to become deputy leader, and Wendy Alexander, the party's Scottish leader. It still might.

Just as bad, Mr Brown's defence of Mr Hain, though tepid, now looks foolhardy. And though his public profile has never matched his own vaunting ambition, Mr Hain was at least a recognisable face, and a sometimes outspoken voice, in a cabinet mostly populated by relative unknowns and overshadowed by a domineering and (at the moment) somewhat unpopular prime minister. After more than a decade in government, Labour's pool of untapped ministerial talent is not overflowing.

Another result of long-term incumbency, some may infer, is a high-handed attitude to the rules—and sleaze. That impression will be reinforced by the police investigation, itself an echo of the loans-for-peerages probe that dogged the end of Tony Blair's premiership: awful for Mr Brown, and wonderful for the Tories. The truth is that British politics is not as sleazy as episodes like this make it seem. But for that, the politicians can only blame their own “incompetence”.

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The poor

Undeserving

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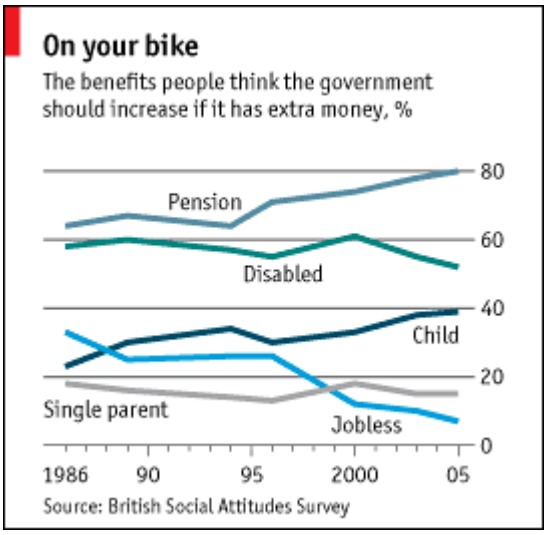
Hearts are hardening against those who have least

THE poor may be always with us, but just who they are is a matter for debate. Officially, someone who gets less than 60% of the median income counts as poor, but people take a harsher view. When asked, half say that those with enough to eat and live on are not poor, even if they can't afford anything else.

Whoever the poor are, Britons care less about their plight than they did 20 years ago. According to the British Social Attitudes Survey, published on January 23rd, more now say the poor have only themselves to blame. The unemployed are particularly vilified: "laziness or lack of willpower" got them where they are today, according to three Britons in ten.

Perhaps this shift stems from a feeling that the increase in government spending on the poor has gone far enough? In fact, policy appears to have followed opinion, rather than shaped it. Most extra cash has gone to children and pensioners, both regarded as comparatively deserving (see chart). Unemployment benefit has fallen behind—and quite right too, is the general sentiment. The proportion of Britons who put the jobless near the front of the queue for more taxpayers' money has plummeted over the past two decades, from a third to 7%.



Hearts have hardened as living standards have soared. Two-fifths now say they are living comfortably; just 14% say they have trouble making ends meet, down from a quarter in 1986. That means fewer see poverty close up—and some of the hostility towards the poor does seem to stem from ignorance. Only two-fifths think a childless unemployed couple on benefits are poor—but when told that they get only £88 ($172) a week after housing costs, this nearly doubles.

Beliefs about the characteristics of those in poverty have also changed. This is partly because the poor have too: those who are still poor after a rising economic tide has lifted most boats are those carrying the heaviest cargo. A further two decades' experience of the welfare state has left more people cynical about the perverse incentives caused by the social safety net: almost all Britons now believe that many jobless are benefit cheats, and more than half that too-generous hand-outs have put them off finding jobs. As millions of immigrants have been effortlessly absorbed by a buoyant economy, the excuse that there just aren't any jobs seems lame.

This new lack of fellow feeling marks Britain out from continental Europe, says Peter Taylor-Gooby, who led the analysis of the data. He speculates that Britain's winner-takes-all voting system makes its politics "sharper-edged and cruder" than elsewhere, hardening social attitudes. Whatever the cause, though, what Britons know, or think, about poverty has changed less than what they want done about it. Most still say society is too unequal and that ordinary people get too little of the nation's wealth. But increasingly they feel that poverty is not the government's problem—or theirs.

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Britain and Europe

Push-pull

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Europe still divides all three main parties—against themselves

ALTHOUGH most Britons prefer to ignore it, the European Union (EU) has played a momentous role in their country's recent past. Rows over Europe helped to bring down two Conservative prime ministers: Margaret Thatcher and John Major. Labour was similarly riven until the late 1980s, when pro-Europeans began to dominate. The last economic blow to shape politics (Britain's forced exit from the exchange-rate mechanism in 1992) was of European origin; the debate on joining the single currency hung over Labour's early years in power.

The shadow cast by Brussels is lengthening over Gordon Brown's premiership. On January 21st the House of Commons began what may be 20 days of debate on the EU reform treaty. Signed in Lisbon on December 13th, it succeeds the draft EU constitution thrown out by referendums in France and the Netherlands in 2005. That Parliament is ratifying it rather than voters is itself controversial: the government, led by Tony Blair at the time, promised a referendum on the constitution in 2004.

The Conservatives regard the Lisbon treaty as different only cosmetically from the original constitution, a view shared by the European Scrutiny Committee in the Commons. On January 20th the Foreign Affairs Committee weighed in with the view that its foreign-policy provisions are nearly identical to those in the constitution. Most voters want the promised plebiscite, as do some Labour backbenchers—18 of whom signed an amendment that is expected to be put to a Commons vote.

The government, knowing that the treaty would almost certainly be thrown out were it put to the public, makes much of the fact that it amends rather than replaces previous treaties, and so need not be. Further enlargement of the EU, which the Tories support, requires the institutional reforms contained in the treaty, ministers say. Rejecting a document that other European nations regard as gallingly generous to Britain (Mr Blair negotiated various opt-outs, though their durability is questioned) could even force a showdown over British membership of the EU—an especially unwelcome prospect at a time when Britain is relying on EU support in its fraught relations with Russia (see article).

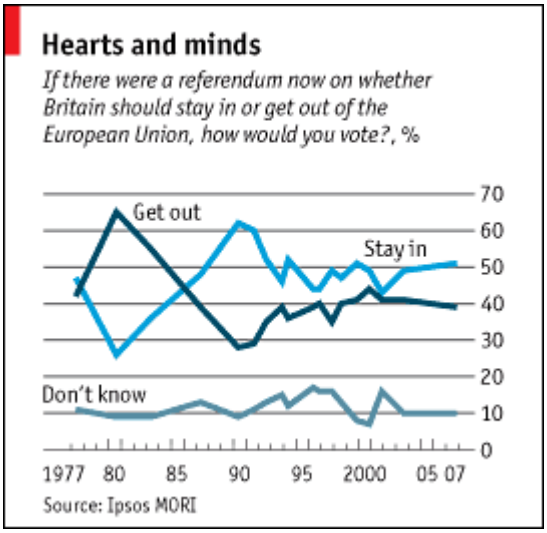
The treaty is likely to be ratified despite the small backbench rebellion. But even if the immediate difficulty passes, Europe remains a thorny issue for all three main parties. Labour MPs, mostly good Europeans (by British standards, anyway) under Mr Blair, are accused of indecision and ambiguity under Mr Brown, as their pro-European instincts collide with the fear of alienating a largely Eurosceptic electorate. Attempting to square this circle led to the prime minister's clumsy handling of the treaty-signing last year (he turned up, but hours after the official ceremony).

The Tories, for their part, are now an almost exclusively Eurosceptic party; Europhile grandees such as the former cabinet ministers Kenneth Clarke and Michael Heseltine have few heirs. But Labour hopes to drive a wedge between the party's moderate Eurosceptics and radicals who may ultimately favour withdrawing from the EU entirely. Senior Tories are confident that the party will remain united during the Commons debates. But many of the hardliners are young MPs, so the fissures may endure. Eurosceptic policies have already tripped up the Tory leader, David Cameron: his pledge in 2005 to withdraw from the main centre-right group in the European Parliament has not yet been fulfilled, and he is struggling to say exactly what a Tory government would do about the treaty if it had already been ratified.

The Liberal Democrats are the most united on the issue. Few are Eurosceptic, though Vince Cable, their treasury spokesman, is more cautious than most. But trying to reconcile their pro-European instincts with their democratic values forces them into awkward positions: they oppose a referendum on the treaty but propose one on EU membership, something most Britons wish to preserve (see chart). Their challenge is to persuade wary voters that the party's Europhile enthusiasm has

limits. Nick Clegg, their leader and a former member of the European Parliament, is expected to talk more about reforming Brussels than his predecessors, and the term “federalist” is being jettisoned.

As Britons of all political stripes argue, duck and dither on Europe, however, the impatience of true EU believers in Brussels is fast increasing (see article). Time and treaties wait for no man.



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Northern Ireland

The old order changeth

Jan 24th 2008 | BELFAST
From The Economist print edition

What next for Ian Paisley?

IT WAS never going to be easy for the Rev Ian Paisley to sell power-sharing to the Democratic Unionist Party (DUP) he leads. The reward for co-operating was high: Mr Paisley was made first minister of Northern Ireland's Assembly. But so was the price. The sight of him chatting and laughing with the deputy first minister, Martin McGuinness, Sinn Fein's chief negotiator and a former leader of the IRA, turns the stomachs of Mr Paisley's followers.

On January 18th Mr Paisley stepped away from the helm of the church he founded. After 56 years he is relinquishing the leadership of the Free Presbyterian Church (which launched his political career) to his deputy. Some see in this spiritual resignation signs of temporal weakness. Mr Paisley has been sapped by age and by slow-burning resentment at his new politics. His church members have long been his most faithful followers, and when his retirement was announced last September, church officials said tactfully that being first minister was job enough for any octogenarian. In reality, he jumped before being pushed by a congregation who felt betrayed when their leader abandoned a lifetime's intransigence. His hold on his party is somewhat firmer but, although no immediate rebellion is likely, some suspect that the DUP may be contemplating post-Paisley politics.

Compounding his troubles are the misjudgments of a son whose career Mr Paisley has nurtured. On January 15th came allegations that Ian Paisley junior, a member of the Stormont Assembly, had used the power-sharing talks that got his father the top job in Northern Ireland to lobby for business interests in his North Antrim constituency. Jim Allister, a member of the European Parliament and a disaffected ex-member of the DUP, published a letter from the British government dated October 13th 2006—the last day of the negotiations. Signed by a minister at the Northern Ireland Office, it was titled “Requests to the Government from Ian Paisley Jr.” and began: “The Prime Minister has considered your requests and has agreed that we should try to respond positively.”

The younger Mr Paisley's requests appear to have been rather petty, considering the momentous occasion on which they were made. They included money for a motorcycling event in his constituency, improvements to a local road and support for two building projects involving Seymour Sweeney, a businessman and DUP member for whom both Paisleys have lobbied. Although little progress on any of these pet projects is apparent, Mr Allister accuses Mr Paisley junior of shifting the focus of negotiations from matters central to unionists to lesser constituency concerns.

The DUP promptly asserted that the requests were neither approved by its officers nor part of their negotiations. Paisley minor said he was guilty only of “eagerness” on behalf of constituents but apologised if he had embarrassed the party.

On January 19th he blurted out in a radio interview that Peter Robinson, the party's deputy leader, would eventually become leader. This lent credence to a report two days earlier in the *Irish Times* (dismissed by a party spokesman) that the DUP's eight MPs had discussed the succession, and that his father would retire as an MP next year. Whatever happens, perhaps the Paisley paterfamilias should be content at pulling off an otherwise-unsellable political deal. As for dynasty, handing his Westminster seat to his son may have to satisfy both of them.

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Reforming the police

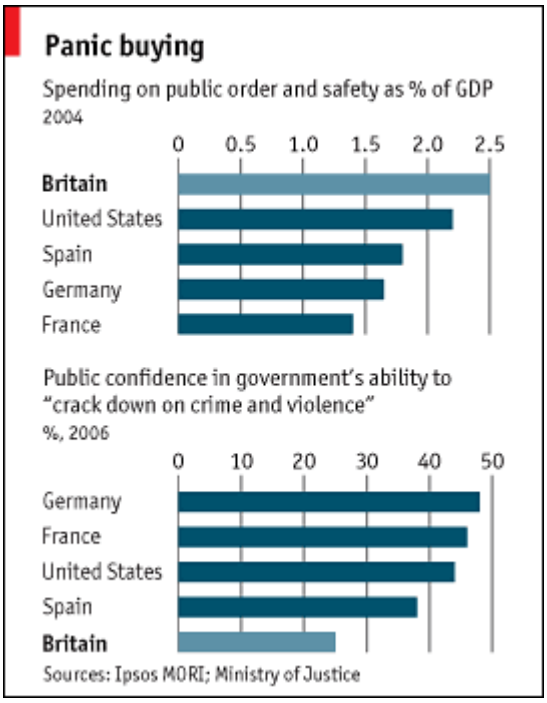
Boys in blue head into the red

Jan 24th 2008
From The Economist print edition

Police funding faces a squeeze. That may not be so bad

IT WAS the world's most orderly demonstration. On January 23rd, 22,000 police officers marched through London to protest against the government's decision not to backdate a new pay deal. Some 150 colleagues in the Metropolitan Police supervised the march while a helicopter hovered above, policing the policing of the police.

The government's treatment of police officers, who are forbidden to strike and therefore easy to bully, is unfair. Yet recently the police service has done rather well: funding is up by a quarter in real terms since 2001, making it the highest in the OECD. Despite this splurge, however, the public still does not trust the government much on crime (see charts). Polls show that law and order is a bigger worry than it was a decade ago, even though most crime has been falling and there are more policemen than ever.



Invisibility is one problem. Although there are 18,000 more officers than in 2000, only 15% of their time is spent on patrol. They have also been nibbling around the edges of crime. The number of offenders brought to justice has gone up, but much of it is down to wily coppers meeting targets by dishing out warnings for cannabis possession, drunkenness and the like. Individually, policemen don't detect any more crimes than they did before the government's spending spree; instead, the extra money has meant that each detection costs the taxpayer 10% more.

As Labour has found with other public services, it is better to reform before spending. Next month a wide-ranging report commissioned by the government will come up with various suggestions. But reforming the police is hard. Control of each force is split between central government, the chief constable and a local board of worthies. There is no national police command, but a range of bodies representing different officers and interests. A plan to amalgamate the 43 forces in England and Wales into 13 bigger jurisdictions ran aground in 2006, and no one has dared to try anything so radical since then.

Poverty could change that. After years of plenty, leaner times lie ahead: in October the Treasury announced an increase in police funding of 4.7%, well below the 8% that police chiefs had requested. Bob Jones, chairman of the Association of Police Authorities, fears that shortfalls could lead to a loss of 6,000 officers.

One consequence is that forces may end up working more closely together after all. Amalgamation is unlikely (smaller forces tend to oppose it), but some are already collaborating to save money. Essex and Kent are developing a joint strategic command for their ports; four Yorkshire forces are running a policy unit for undercover officers. Gavin Lockhart of Policy Exchange, a research outfit, argues that such collaboration helps to tackle serious cross-border crime as well as save money.

Further efficiencies could be found in specialisation. Higher pay for officers who focus on gangs, say, or drugs, would help forces get more bang for their investment, according to Guy Lodge of the Institute for Public Policy Research, another think-tank. The demands on constables could be eased further by making more use of civilian staff on the front lines, gathering evidence, providing support for victims and so on, he suggests.

Farther down this road lies the thornier question of privatisation. Privately-run prisons tend to score lower than those run by the state, as do private immigration-removal centres. Mr Lockhart reckons that private failures are down to bad procurement, and highlights successful examples such as the Sussex police, who contracted out some of their guard work and seem happy. Such ventures are likely to grow more common as forces scrimp.

Less clear is how tighter fiscal times will influence the government's thinking on introducing local accountability to policing. The Tories want elected sheriffs to call the shots; others worry that this would lead to populism. So far the government has not rushed to devolve much power to local authorities, but, given the polls, crime might be an issue that it would be glad to offload. Whatever it chooses, it seems that so far law and order is not a realm where money can buy public support.

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Medical care

Paying a deadly price

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Uniform pay in the NHS costs lives

THERE are few things that incense the British more than the notion that the quality of their medical care depends on where they live. Fear of a “postcode lottery” helps explain why the NHS remains so centralised, despite frequent calls for more local say. Yet, as research* published on January 22nd shows, central control has fostered the very postcode lottery it was supposed to avoid.

The study investigates the impact on medical care of imposing virtually uniform pay rates in the NHS throughout England, even though wages in the private sector vary widely among regions. The researchers—Emma Hall and Carol Propper of Bristol University, and John Van Reenen of the LSE's Centre for Economic Performance—look at how this affects the calibre of nursing staff rather than that of doctors because nurses are more likely to seek other jobs if they are dissatisfied with their pay.

In inner London, where the cost of living is highest, nurses were paid only 10% more than the national rate in the period from 1996-97 to 2001-02 (the most recent with comprehensive figures). Yet female nurses can also work in a wide range of private white-collar jobs, as well as in independent hospitals. Regional wages for such work vary widely: women earned on average 65% more in inner London than in the north-east.

Its rigid pay policy makes it easy for the NHS to recruit and keep good nurses in poorer northern regions but hard to hire and retain them in the richer south. Hospitals in the north gain from a more stable pool of nurses. Southern ones have to lean on temporary agency nurses, who can be paid more but tend to be less experienced, less familiar with the hospital and less productive. Do southern patients suffer as a result?

The economists look at the proportion of patients aged 55 or more, admitted to hospital after a heart attack, who die within 30 days. They find a strong link between this ratio and local private-sector wages. The higher the private wage, making it harder to get good nurses in the NHS, the higher the death rate: to be precise, if the private wage is 10% higher in one area than another, the death rate is 4-5% higher.

Nurses have been awarded big pay increases since 2001-02, and this has eased stresses in the south. They are likely to re-emerge, however, as pay is restrained in the lean years ahead. And national pay bargaining dominates the public sector. State schools in rich regions find it hard to recruit good staff, for example: teachers on national pay scales prefer cheaper places to London, especially once they have children.

Regional differences in prosperity have widened under Labour, which makes it more important that the government stop treating the country as if it were economically uniform. Rather than insisting on three-year wage deals, it should allow for greater regional variations in public-service pay—a reform that Gordon Brown backed at the Treasury but never carried through.

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*”Can Pay Regulation Kill?”, by Emma Hall, Carol Propper and John Van Reenen. Centre for Economic Performance. January 2008.

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Identity cards

Dead, or just sleeping?

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Identity cards for all recede into the distance

PART of the appeal of conspiracy theories is that they are perversely reassuring, portraying, as they do, an omniscient government immune to error, forgetfulness and other human frailties. Sadly, a string of embarrassing indiscretions involving citizens' personal data have reminded Britons that, in the real world, governments are flawed. Now those same data leaks threaten Labour's ambitious scheme to give everyone an identity card.

On January 23rd the Conservatives showed leaked Home Office papers saying that Britons would be issued with ID cards from 2012, two years later than the original target date (foreign nationals will require ID cards from this year, as planned). By itself, that may seem unsurprising. The cards and the database to power them (at a total cost of £5.4 billion) will be the most complicated in the world. Up to 49 different pieces of information will be stored, from iris patterns and fingerprints to dates of birth and past addresses. Some of those data will be shared by government departments and could potentially be used by private firms as well. Given the government's spotty record on big computer projects, delays would shock no one.

Putting off the introduction of identity cards until after the next election, which must happen by May 2010, would also remove the chance for embarrassing mishaps in the run-up to the polls. On recent form, that would be wise. In November tax officials dented the government's data-security credentials when they admitted losing the personal details of 25m benefit claimants. More butter-fingered examples emerged. These included the details of 3m drivers lost in Iowa, a misplaced laptop containing information about potential army recruits and reams of paperwork from the Department for Work and Pensions—featuring photocopied passports, mortgage information and benefit details—dumped on a roundabout in Exeter.

Since then, support for ID cards has been muted. Officials used to say they would be compulsory—indeed, David Blunkett, home secretary when the cards were first mooted, argued that voluntary cards would be pointless. But in an interview this month Gordon Brown hinted this might not be the case. Pressed later by David Cameron, the Tory leader, the prime minister was less than enthusiastic, eventually saying that compulsion was for MPs to decide. Civil servants have been tight-lipped about progress. The information commissioner, a data watchdog, is trying to persuade a court to order publication of a government feasibility study, and an assessment of private-sector uses for the cards has yet to see daylight. Some are beginning to smell a climb-down.

Such pusillanimity pleases opponents of ID cards, many of whom see disadvantages beyond data leaks. Some fret about the cost; others say that no coherent case for cards has been made (justifications vary from preventing terrorism and policing immigration to forestalling benefit cheats and thwarting identity thieves). And although Britons are already among the most-watched people in the world, ID cards are a step too far for some. Nick Clegg, the Liberal Democrat leader, has said that he would go to jail rather than carry one. Judging by opinion polls and widely circulated pledges to disobey, a significant fraction of his countrymen feel the same way.

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Bagehot

In the red corner

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From The Economist print edition

A hidden compliment, and a big question, in Britain's fall-out with Russia

Illustration by Steve O'Brien

RED is the colour of “From Russia”, a raucous new exhibition at the Royal Academy of Arts. The dress worn by a Russian peasant woman, the roofs in a futuristic Moscow, the quizzical horse ridden by a lean Russian youth and Chagall's “Red Jew” all blaze red. The colour encapsulates many of the exhibition's themes: red is for Orthodox iconography and Soviet power, and for blood. The main theme, however, is Russia's perpetual, complex dance of envy and emulation with the West. The show chronicles Russian avant-garde painters' eccentric reactions to France, but the exhibition itself is part of Russia's angry yet enamoured tango with another country: Britain.

By post-cold-war standards, Anglo-Russian relations are noxious—so bad that for a while it seemed that “From Russia” might be cancelled. Though the show went on, British diplomats worry that the relationship might break down altogether, were Russia's byzantine internal politics to make that useful. Beneath the iciness, however, lies a kind of compliment—and a question about Britain's place in the world.

Snow on their Manolo Blahniks

In December the Russian government ordered the British Council, which promotes British culture and education abroad, to close its offices in St Petersburg and Yekaterinburg. This month, when the British refused, the Russian authorities accused the head of the St Petersburg office of driving offences, and subjected the council's Russian staff to security-service interviews and nocturnal visits from the tax police. Though alleged irregularities are sometimes cited, Russian officials have also linked their bullying to the expulsion of Russian diplomats from London in July 2007—itself an after-effect of the murder of Alexander Litvinenko by radioactive poisoning in London in 2006.

What the friction says about Russia's disregard for international niceties is plain. But what does it say about Britain? Though other countries have fallen out with Russia in its oil-fuelled, Putin-era pomp, the Kremlin has been particularly rough with Britain. Even before Litvinenko, the estimable British ambassador was harassed by a Kremlin-backed youth group and the BBC obstructed. In early 2006 the FSB, successor to the KGB, bizarrely used a television programme to accuse several British diplomats of espionage. The hostility stems partly from the political asylum Britain gave a renegade Russian oligarch

and a Chechen separatist, who followed pre-revolutionary radicals and post-revolutionary Whites by seeking sanctuary in London. But the explanation is deeper and more complicated than that.

From the Crimean war through tussles in Persia, Afghanistan and Tibet, the British empire was the old Russian empire's main rival. Britain's navy has been admired in Russia since Peter the Great learned shipbuilding in London in 1698 (and trashed the house he stayed in). British spies are distrusted but respected by their Russian counterparts (witness the head of the FSB's recent wild claims about British plans to dismember Russia). Britain's political institutions, meanwhile, have always been revered by Russian liberals. Though France and Germany invaded, and America is the hyperpower, emotionally Britain is still the natural power for muscle-flexing, neo-Soviet Russians to confront—even if Britain's imperial grandeur is as outdated as the pea-soup fogs that, according to Russian textbooks, still engulf London.

It isn't only politics. Russia's artists turned to France for inspiration, but its 19th-century aristocrats took their idea of ease and independence from Britain and its country houses. Their post-Soviet equivalents have opted to buy the originals: the new Russian rich throng London's poshest postcodes, restaurants and art galleries. Their children (including those of nationalistic ministers and apparatchiks) attend Britain's best-known schools and universities. Friendly tax rates, reliable banks and courts, and the London Stock Exchange—on which many Russian firms have floated—are part of the appeal too, of course. The Russians have exposed an old truth: a middling amount of money seems vulgar, but a large amount of money opens almost all doors. There are hundreds of thousands of ordinary Russians in Britain too: applications for British visas are rising by 20% a year. The flamboyance of its expats, and cultural exports such as “From Russia” and the sensational soprano Anna Netrebko (wowing audiences at the Royal Opera House), have given the country an unprecedented, and mostly positive, profile in Britain.

So the tension seems odd. But there may be a link between the Kremlin's anathemisation of Britain and that country's popularity. What seems to have angered Russians particularly about the Litvinenko imbroglio is the tightening of the visa regime for official visitors that resulted; loosen it, they now say, and we can talk. Some people may be punishing Britain, in other words, precisely because they are fond of it. One way or another this contradictory Russian attitude—in equal parts resentment and esteem—is a testimony to Britain's openness and dynamism, and to a historical renown that is still an important asset.

So much for the compliment: the question is whether and how modern Britain can respond to the menace that also comes “From Russia”, and indeed to other big threats. David Miliband, then a brand-new foreign secretary, was refreshingly robust over the Litvinenko affair last year. This time he confined himself to denouncing Russia's “blatant intimidation” as “not worthy of a great country”. That has managed to irk the Russians (“neo-colonial”, they say) without influencing them. The truth is that—for all its repute in Russia and beyond—Britain by itself can do little to sway the Kremlin. Its European partners have spoken up a bit; but the lesson for Gordon Brown especially may be that if Britain is to punch above its weight—and resist the punches that come back—it needs to show less cold shoulder and more collegial respect to the countries who really are its friends.

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Economist.com WORLD INTERNATIONAL

Environment and development

How green is their growth

Jan 24th 2008
From The Economist print edition

Panos

A new argument that economic progress can help to ease environmental woes, just so long as the governance is good too

Get article background

CAN poor countries afford to be green? That is a question which politicians in the developing world have often asked rather pointedly. To them, it seems that the obsession of some rich types with preserving forests and saving cuddly animals like pandas or lemurs, while paying less attention to the human beings living nearby, is both cynical and hypocritical.

There is, of course, plenty of evidence that greenery and growth are not polar opposites. After decades of expansion in China and other fast-emerging economies, some of the negative side-effects and their impact on human welfare, above all the death toll caused by foul air and water, are horribly clear (see article). Yet the relationship between growth and the state of the environment is far from simple.

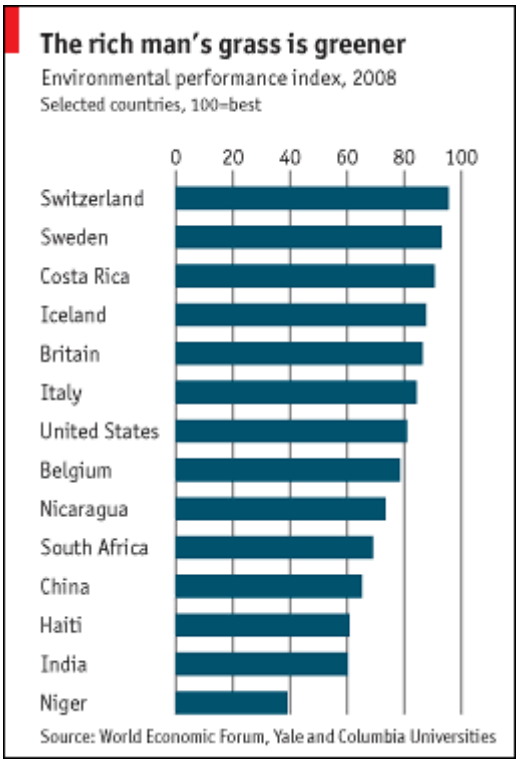
Some new light has been cast by a team of researchers led by Daniel Esty of Yale University, who delivered their conclusions this week to the World Economic Forum in Davos, Switzerland. What they presented was the latest annual Environmental Sustainability Index, which grades the “environmental health” of 150 countries—using many indicators, from population stress and eco-system health to social and institutional capacity. This year's report focuses on the link between the state of the environment and human health.

In a nutshell, what the new report (also sponsored by the European Commission and Columbia University) suggests is that poor countries have been quite right to challenge the sort of green orthodoxy which rejects the very idea of economic growth. Indeed, the single biggest variable in determining a country's ranking is income per head. But that doesn't imply that economic growth automatically leads to an improvement in the environment.

The team's finding is that growth does offer solutions to the sorts of environmental woes (local air pollution, for example) that directly kill humans. This matters, because about a quarter of all deaths in the world have some link to environmental factors. Most of the victims are poor people who are already vulnerable because of bad living conditions, lack of access to medicine, and malnutrition (see article). Among the killers (especially of children) in which the environment plays a role are diarrhoea, respiratory infections and malaria. These diseases reinforce a vicious circle of poverty and hopelessness by

depressing production. According to the World Bank, the economic burden on society caused by bad environmental health amounts to between 2% and 5% of GDP.

Mr Esty's analysis suggests that as poor countries get richer, they usually invest heavily in environmental improvements, such as cleaning up water supplies and improving sanitation, that boost human health. (Their economies may also shift gear, from making steel or chemicals to turning out computer chips.)

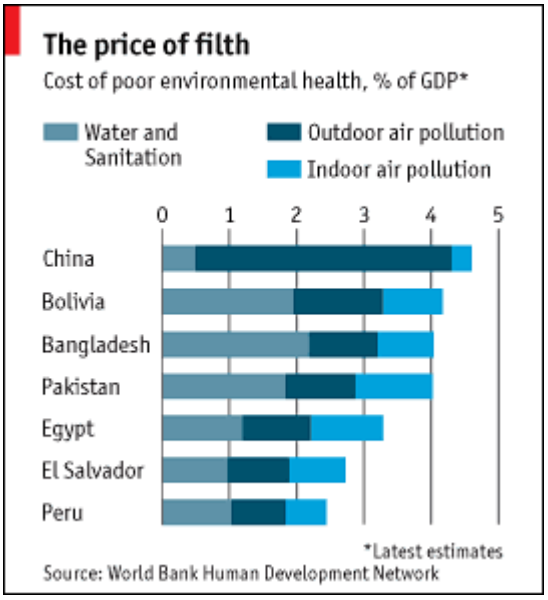


But the link between growth and environmentally benign outcomes is much less clear, the study suggests, when it comes to the sort of pollution that fouls up nature (such as acid rain, which poisons lakes and forests) as opposed to directly killing human beings. The key to addressing that sort of pollution, Mr Esty argues, is not just money but good governance.

A closer look at the rankings makes this relationship clearer. Of course it is no surprise that Switzerland fares better than Niger. But why is the poor Dominican Republic much healthier and greener than nearby Haiti? Or Costa Rica so far ahead of Nicaragua, whose nature and resources are broadly similar? And why is wealthy Belgium the sick man of western Europe, with an environmental record worse than that of many developing countries?

A mixture of factors related to good government—accurate data, transparent administration, lack of corruption, checks and balances—all show a clear statistical relationship with environmental performance. Among countries of comparable income, Mr Esty concludes, tough regulations and above all, enforcement are the key factors in keeping things green.

All this may be a helpful way of looking at pollution in the classic sense, but there is another factor that may upset all previous calculations about the relationship between growth and the state of the earth: climate change. Greenhouse emissions do not poison people, or lakes or woods, in the direct or obvious way that noxious chemicals do. But at least in the medium term, they clearly alter the earth in ways that harm the welfare of the poor.



Paul Epstein of the Harvard Medical School says the impact both on nature and directly on humanity of global warming will swamp all other environmental factors. As alterations in the climate lead to mass migrations, epidemics will spread; as temperate zones warm up, tropical diseases like malaria will surge; storms will overwhelm sewer systems; heat waves will push ozone levels up.

He may be right, but here too economic growth, coupled with good governance, may yet prove to be a source of solutions rather than problems. At the moment, perhaps 2 billion people have no formal access to modern energy—they make do with cow dung, agricultural residue and other solid fuels which are far from healthy. Unless foresight and intelligence are applied to the satisfaction of these people's needs, they may embrace the filthiest and most carbon-emitting forms of fossil-fuel energy as soon as they get the chance.

A mixture of economic growth and transparent governance may offer the only chance of avoiding that disaster. Indeed, everyone will gain if poor countries find a way to leapfrog over the phases of development which in so many other places did terrible harm to the environment.

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The Vatican and Islam

A flustered flock of pigeons

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How to talk to Muslims (and others); Catholics seem unsure

Get article background

WHEN 138 Muslim scholars sent an open request to leaders of the Christian world, from Catholics to Methodists, for a theological dialogue, they knew they were setting a cat among the pigeons. It was a fair bet that senior Christians would soon be looking over each other's shoulders, anxious not to be too liberal or too harsh in their reply.

And something like that has happened. America's Southern Baptists have blamed mainstream Protestants for responding too warmly; and even the usually well-organised Catholics have been less than co-ordinated. The Vatican's point man on inter-faith relations, Cardinal Jean-Louis Tauran, initially saw little scope for talking to Muslims about theology. But Pope Benedict XVI later agreed to receive some of the Muslim signatories. That process will start soon.

Easily the boldest Catholic response to the Muslim letter has been an essay by an Australian Jesuit scholar, Daniel Madigan, published this month. He took seriously the Muslim idea of a dialogue based on the commands of Jesus of Nazareth to love God and one another. Important as these commands were, they were not the basis of the Christian faith: God's love for man was a more basic point, the Jesuit argued. But for all his quibbles, he did engage with the Muslims' theological views in earnest.

As the largest of the Catholic church's religious orders, the Jesuits like to test the limits of dialogue. Before his death in 2004, a Jesuit pioneer of Catholic thinking on Hinduism, Jacques Dupuis, suffered many scoldings from the Vatican's doctrinal enforcer: then called Cardinal Joseph Ratzinger; now pope.

The Jesuits' new superior-general, elected this month, also exemplifies the order's belief in living “at the frontiers” of culture: like another recent holder of that office (who fell out badly with the Vatican bigwigs), Adolfo Nicolás is a Spanish expert on Japan. He takes office in interesting ecumenical times.

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Economist.com WORLD INTERNATIONAL

Malnutrition

The starvelings

Jan 24th 2008
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Hunger has an even bigger impact on children's health than was thought

BADAAM lives in the Indian province of Rajasthan. Tetanus killed one of her children in infancy; another is weak from diarrhoea, caused probably by the custom of keeping mother and baby isolated for a month after birth. Yet she is one of the lucky ones: a charity, Save the Children, has been keeping her family alive with food and nutritional advice.

Unicef, the United Nations' children's agency, said this week that fewer than 10m children died before their fifth birthday in 2006—probably the lowest rate ever, and certainly the smallest number since records began in 1960, when twice as many under-fives died, out of a world population half today's level.

Good news—but it could have been still better. Malnutrition is by far the biggest contributor to child mortality, present in half of all cases, says the World Health Organisation. New research in the *Lancet*, a British medical journal, suggests it may be one of the "big bills left on the sidewalk"—to borrow the phrase that Mancur Olson, an economist, used for describing easily reaped but neglected benefits.

One paper, by Robert Black of Johns Hopkins University and others, reckons underweight births and inter-uterine growth restrictions cause 2.2m child deaths a year (around one every 15 seconds). Poor or non-existent breastfeeding explains another 1.4m. Other deficiencies—lack of vitamin A or zinc for instance—account for 1m. In all, that is 3.5m deaths (once you strip out double counting)—one-third of total child mortality.

Hunger causes disease as well as death. According to the *Lancet*, malnutrition in the first two years is irreversible. Malnourished children grow up with worse health and lower educational achievements. Their own children also tend to be smaller.

Previous estimates of hunger's impact were higher, but they treated it as something which exacerbates the problems of diseases such as measles, pneumonia and diarrhoea. Those illnesses were seen as the causes of death; malnutrition counted as a contributing factor. But malnutrition actually causes diseases as well, and can be fatal in its own right. This is the impact the *Lancet* authors seek to identify. Overall their findings confirm and quantify the WHO's view that hunger is the gravest single threat to the world's public health.

But they do more than that. As the *Lancet* and Unicef both make clear, dealing with hunger hardly requires a doctorate in the biochemistry of the human body. Breast-feeding advice, food supplements and better hygiene all make a big difference. Most countries know what to do and run pilot programmes that work. But they rarely find the money for full-scale national efforts; the international outfits that might help are, in the *Lancet*'s words, fragmented and dysfunctional.

Yet if the research is right, money for improving nutrition would be the most effective sort of aid around. At the moment, roughly $300m of aid goes to basic nutrition each year, less than $2 for each child below two in the 20 worst affected countries. In contrast, HIV/AIDS, which causes fewer deaths than child malnutrition, received $2.2 billion—$67 per person with HIV in all countries (including rich ones).

Focusing on nutrition and mortality also makes sense, says April Harding of the Centre for Global Development, a Washington-based think-tank, because it forces policymakers to pay attention to health-care systems as a whole, rather than trying to save children "one disease at a time". Given the scale of the crisis, the case for aid organisations redirecting money and attention to the problem of hunger looks compelling.

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Military helicopters

Getting boots off the ground

Jan 24th 2008
From The Economist print edition

Choppers are vital—and hard to find

AP

Take me out of here quick

MOVING troops across southern Afghanistan usually involves a giddy mountain-hugging flight in a transport helicopter—preferably escorted by a mean Apache attack helicopter. Despite the risk from old-fashioned ground fire, particularly in narrow valleys, a ride in a chopper is still better than land travel on ambush-ridden or non-existent roads.

Western military operations in Iraq and Afghanistan would be much riskier, and probably impossible, without the widespread use of helicopters. No NATO meeting passes without a request for the allies to send more choppers to Afghanistan. But even comparatively well-equipped Western forces, such as Britain's, have been stretched to find enough machines.

The situation is even more acute for the United Nations. Its peacekeepers need the power and mobility that helicopters offer in remote, rough places but find it increasingly difficult to beg and borrow enough.

After much delay, the UN has started to deploy to the bloodied wilderness of Darfur, in western Sudan, to beef up the 7,000 African Union peacekeepers and create a hybrid force of 26,000 troops. Foot soldiers have been fairly easy to find, but no country has yet provided the 18 transport and six attack helicopters that the UN requested. Without such airlift, the new force may be as powerless as the one it replaces. In neighbouring Chad and the Central African Republic, a parallel European Union peacekeeping mission struggled to find choppers until France—the main contributor to the mission—reluctantly stumped up ten aircraft. UN officials now doubt they could launch another peacekeeping mission in, say, Somalia.

Is there a real lack of helicopters, or just too little political will? Richard Gowan, of New York University, notes that sub-Saharan countries have many wars but hardly any helicopters; traditional UN troop contributors, such as India, are close to the limit of what they can supply; some Western countries such as America and Britain are overstretched in Iraq and Afghanistan; while others are reluctant to become involved in fighting, be it counter-insurgency or tough peacekeeping.

America has thousands of helicopters but is already worried about its ballooning, billion-dollar bills for wear and tear on its military equipment (and the administration flinches at the thought of military involvement in yet another Muslim country). European NATO countries have more than 1,000 transport helicopters, but still rely heavily on American airlift in Afghanistan. That reflects the outdated design of their armed forces, still focused on territorial defence against a Soviet invasion; military plans assume a defined front line with rear staging areas supplied by road. In Iraq and Afghanistan, however, there are no front lines and road convoys everywhere are among the most vulnerable targets.

Worse, flying in new conflict zones is harder than in Europe. Helicopters perform poorly in hot weather and at high altitude. Both apply in Afghanistan in summer months. Even in low-lying Iraq, British forces found that their Lynx helicopters, designed to carry a dozen soldiers, could manage one passenger at best during the summer heat. Among European NATO arsenals, few helicopters have defensive equipment such as flares and chaff to deflect shoulder-held anti-aircraft missiles.

Helicopters are expensive and delicate machines requiring heavy maintenance, especially when flying in dusty conditions. That means that each aircraft needs about 30 ground crew, who in turn have to be

protected from attack. Countries are reluctant to endanger such valuable—and vulnerable—assets, particularly in uncertain or unpopular missions.

Britain is slowly withdrawing from Iraq, but finds itself fighting an unexpectedly hard campaign in Afghanistan, where it forms the second-largest foreign contingent. In the scrabble to find more helicopters, it has taken over six Merlin search-and-rescue helicopters ordered by Denmark. It is also fixing the costly botched procurement of eight heavy-lift Chinook helicopters, grounded in 2001 because they could not be certified as safe.

Other big European allies are deployed in the quietish north of Afghanistan, and reluctant to become involved in the fight in the south. France and Italy, moreover, say they are heavily committed in other operations, for instance in the Balkans, in southern Lebanon and now in Chad.

For UN peacekeeping, Western countries generally prefer to send money rather than troops and vital equipment. The bulk of the UN's manpower comes from Asian countries such as India, Pakistan and Bangladesh. India is already the biggest donor of helicopters to the UN, while Pakistan is busy fighting militants in its tribal areas. “The situation would change overnight if China, which is starting to get involved in peacekeeping, were to lend some of its helicopters,” says Mr Gowan. Another source might be Russia, Ukraine and other former Soviet-block countries, which have plenty of helicopters, but have so far offered few of them.

For now, the UN makes up the shortfall by hiring private firms to provide helicopter transport. Such commercial aircraft are not insured to fly in combat zones, even to pick up wounded soldiers. But the UN is loth to hire attack helicopters privately; it would seem—horrors—like hiring mercenaries. Yet when 500 UN peacekeepers in Sierra Leone were taken hostage in May 2000, it was not just the arrival of British paratroopers that turned back the advancing rebels; it was the unsung actions of a South African mercenary, strafing and rocketing the rebels from his Soviet-made Mi-24 “Hind” attack helicopter.

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The advertising market

Hard sell

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Reuters

Ad-spending usually plunges when economic growth slows. Will it be any different this time?

WHEN the American arm of Hyundai, a South Korean carmaker, said last week that it was worried about the economy and may cancel its plans to advertise in the Super Bowl, American football's grand finale, on February 3rd, the advertising and media industries shuddered. Marketing spending is one of the first things companies decide to cut when faced with slowing sales. Suddenly a recession in ad-spending seemed imminent. In the event, Hyundai decided to stay in, but buyers and sellers of ad-space know that it is only a matter of time before someone somewhere pulls out for real.

Yet, even as stockmarkets tumble and economies falter, some ad-men expect the knife to cut most deeply in 2009 rather than in 2008. Maurice Lévy, chief executive of Publicis Groupe, a French advertising firm, reckons that despite the chance of a recession in America, 2008 will be a good year for sellers of ad-space. Three big-ticket events—America's presidential election, the Olympics in Beijing and the European football championship—could add as much as 1% of additional growth to advertising expenditure, he says, which could partially offset economic weakness.

Sir Martin Sorrell, chief executive of WPP, another big advertising group, acknowledges that people are anxious. But his clients are not cutting their ad budgets yet and he expects 2008 to be a reasonable year. By contrast 2009 does not have big “quadrennial” political or sporting events, and so could be painful. A new American president will dole out any unpleasant economic medicine immediately, ahead of the mid-term elections, says Sir Martin. That would hit 2009 too.

It is just possible that advertising budgets may prove more resilient than in the past. That is because the internet has brought greater accountability to advertising. Marketing chiefs can now prove that a click on an online ad produces a sale. Firms are trying to impose the same discipline on television and other media spending.

“Now when companies raise their budgets they do so more responsibly,” says Jonathan Barnard, head forecaster at ZenithOptimedia, a unit of Publicis, “and they're less likely to see marketing as a frivolous expense ripe for cutting.” In past booms, he says, money spent on advertising grew much faster than the economy, and ad-spending as a share of GDP shot up. That effect was marked in 1999-2000, when dotcom start-ups ploughed much of their newly raised capital straight into marketing. This has not happened today, so ad-spending may not have as far to drop.

In fact, forecasters disagree about advertising spending in 2008. UBS, a bank, predicts that expenditure on ads will increase by 5%, whereas Goldman Sachs, a rival, forecasts that it will decline by as much as 5%. Most, however, agree on one thing: underlying growth in ad spending will come mainly from emerging economies and from advertising on the internet. Emerging markets now represent one-fifth of global expenditure on advertising, and are contributing ever greater sums. The price of ad-space has risen quickly in some emerging markets, such as Russia and China, and growth is slowing there. Even so, ZenithOptimedia expects developing countries will add $50 billion in new ad-spending in the next three years whereas developed markets will add only $38 billion—the first time that emerging markets have come out top over such a period.

In rich countries the internet is claiming a growing share of advertising—at the expense of traditional media, such as TV and print. There is still a gap between the time people spend online as a fraction of their media consumption (about a fifth) and the fraction of marketing budgets spent on the internet (about 7.5%). Many companies are trying to narrow the gap, which will sustain internet advertising during a downturn. Search advertising, the most effective kind of all, should be safest.

Indeed, some people say an economic slowdown is likely to accelerate the shift to the internet. Trevor Kaufman, chief executive of Schematic, an interactive agency based in Los Angeles which was recently bought by WPP, says that one of his clients, an American “big-box” national retailer, intends to devote more of its marketing resources to the internet as the economy slows. The internet's interactivity and wealth of product information make it the best means of generating short-term sales—whereas television is best for long-term brand-building. During a downturn clients see internet ads as easier to measure and hence easier to justify to shareholders, says Mr Kaufman.

But online advertising cannot hope to escape an ad recession altogether. The quadrennial effects of 2008 will mainly benefit television and newspapers. In addition, argues Deloitte, a consultancy, online ads face new obstacles. It points to a recent survey of American consumers which found that more than three-quarters of respondents said online ads were more annoying than those in print. Concerned about their privacy, people have started to lobby against online tracking of sales, which is a vital element of the internet's much-vaunted effectiveness.

Some industries will cut ad-spending more deeply than others, says James Walker of Accenture Marketing Sciences. Many banks, hit hard by losses, have already cut back on their spending, according to media executives. Makers of cars and luxury goods and other dispensable items will be more exposed to a recession than companies that sell necessities. Bart Becht, chief executive of Reckitt Benckiser, a British consumer-goods company that makes dishwashing powder and other basic goods, says his firm is not planning to cut its media budget for this year, “though we may advertise less on TV.” Watch this space.

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Australian media

Likely lads

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The sons of two media moguls join forces

NEWS about the Packers and the Murdochs often feels as if it demands commentary not just from media analysts, but from psychologists too. From the founding fathers, Sir Frank Packer and Sir Keith Murdoch, down through their sons, Kerry and Rupert, to the modern-day scions, the families have provided tales of dynastic ambition, seething feuds, occasional rapprochements—and recently, joint ventures.

The latest instalment features James Packer, who took control of the Packer empire after his father's death in 2005, and his friend, Lachlan Murdoch, who in the same year abruptly resigned from his father's media empire, News Corporation. This week the pair announced that they would spend $A3.3 billion ($2.8 billion) to take joint control of Consolidated Media Holdings (CMH), a firm that came into being last November, when Mr Packer split his father's PBL empire into two separately listed companies: one focusing on media, Kerry's abiding passion, and the other on gaming, James's main love.

Before the split, Mr Packer had already sold most of his father's empire to a private equity firm, CVC Asia Pacific, including a controlling stake in Channel Nine, a television network that used to dominate Australia's airwaves but which has since lost viewers. CMH comprises what is left: stakes in Channel Nine, ACP Magazines (which includes titles such as the *Bulletin* and *Women's Weekly*), Foxtel, Australia's largest pay-TV operator, and Fox Sports. Under their 50-50 joint venture, Messrs Murdoch and Packer plan to take CMH private, and they are offering A$4.80 for each share, almost 25% above their market value. The pair's first move, this week, was to shut down the *Bulletin*, a 127-year old weekly news magazine which had been making losses.

Making changes to the bigger media properties, however, will be difficult because CMH does not control them. It owns just 25% of Foxtel, for instance, and 25% of PBL Media, which owns Channel Nine. The deal is about managing financial assets rather than running companies in a hands-on manner, says Mark McDonnell, a media analyst with BBY, an investment bank. Some analysts wonder whether Lachlan could in fact be positioning himself as buyer-in-waiting for when CVC Asia Pacific decides to sell.

Rather like an Aussie afternoon “soapie”, everything ended in tears—literally—the last time the two men went into business together. James broke down in Lachlan's kitchen at home as One.Tel, a mobile phone company that they had both invested in, filed for bankruptcy in 2001. Their combined losses were estimated to be about $A1 billion. Some even speculate that James, a cheerleader for One.Tel before its collapse, is keen to make it up to Lachlan by asking his friend to become a co-owner of the family business. He could also do with Lachlan's media expertise.

Lachlan has just as much to prove. As Rupert's eldest son he was thought to be the heir to his father's giant media empire, but seemed to reject that path when he left the firm. Last December Rupert moved Lachlan's younger brother, James, to run News Corp's European, Middle Eastern and Asian operations, widely seen as preparation for taking the top job at some point. This is Lachlan's first sortie back to the media industry's frontline since then—which is where the pop psychologists weighed in.

Lachlan's family connections also raise regulatory questions, so he has been at pains to point out that this transaction has nothing to do with News Corporation, whose Australian arm also owns stakes in Foxtel and Fox Sports. He is still a non-executive director of News Corporation. That has stirred the interest of Australia's competition regulator, which is now studying the plan. “He maintains he's independent,” says its chairman, Graeme Samuel. “Well, we'll have a look at that.”

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The pharmaceutical industry

The bitterest pill

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Drugs firms have found new ways to keep generic medicines at bay

“IF WE have the feeling that something is rotten in the state, then let's take the opportunity to find out.” So said Neelie Kroes, the European Commission's competition commissioner, seeking to justify a spectacular raid last week on big pharmaceutical companies. Officials are investigating whether sellers of expensive branded pills conspired together to delay the launch of cheap generic rivals. America's Federal Trade Commission (FTC) is also looking into it.

Many of Big Pharma's biggest blockbusters will soon lose their patent protection. Deloitte, a consultancy, estimates that $55 billion of products will go off patent in 2009 and will then face competition. At the same time, pharma bosses are being asked to defend patents in costly legal battles against an increasingly confident and litigious generics industry. As generics firms evolve from mere copycats into innovators in their own right, many such firms—led by Israel's Teva, India's Ranbaxy and Dr Reddy's Laboratories—are vigorously challenging patents.

The best way out for the established drugs industry would be to find lots of clever new blockbusters to replace the ones going off-patent. But as the industry's sagging share valuations suggest, the new-drugs pipelines at big firms have run dry. So their managers are relying on two controversial new strategies. First, they are settling the lawsuits brought by generics firms, sometimes paying them to delay launching cheap pills. Novartis, a big Swiss firm, recently made a private settlement for Dr Reddy's to drop a lawsuit in return for the Indian firm delaying the launch of a generic rival to Exelon, its Alzheimer's remedy. This month it emerged that GlaxoSmithKline (GSK), a big British pharmaceutical firm, has also settled a patent lawsuit with Ranbaxy concerning the generics firm's launch of a cheap version of Imitrex, GSK's migraine reliever.

Under American laws designed to encourage generic drugs, which save money for patients, the first generic maker to win regulatory approval for its version of any given branded drug is supposed to enjoy a six-month monopoly. This promised pot of gold was designed to support small generics firms—but Big Pharma has found a loophole. It is pre-emptively launching generic versions of its own branded pills, which wipes out those six months of monopoly profits and undermines the economics of generics firms.

Merck, a big American pharmaceuticals firm, is soon expected to launch an authorised generic version of Fosamax, an osteoporosis drug that is due to lose patent protection in February. A recent survey of global branded-drugs firms by Cutting Edge Information, a consultancy, found that a third of them had launched authorised generics between 2005 and 2007—and the number will grow to 44% between 2008 and 2010. Pfizer has set up an in-house division to handle such generics.

The recent steps taken by regulators in America and Europe to investigate Big Pharma looks like good news for generics firms—unless, that is, some of them turn out to have been complicit in the alleged dirty tricks. Earlier this month, America's FTC extended its probe to include generics companies. And during last week's raid by European investigators, one of the firms targeted was Teva, a generics pioneer. The generics industry is defiant, arguing that it remains the consumer's best friend despite its settlements with the enemy. Kathleen Jaeger, head of the Generic Pharmaceutical Association, insists that officials must avoid taking action that “sweeps the bad settlements in with the good settlements”. It remains to be seen whether the upstart pillmakers have been playing for time or selling out.

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European business schools

Insead out?

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New schools and new rules are stirring things up

Get article background

TIME was when INSEAD in Fontainebleau, near Paris, was the top business school in Europe, with no competition. In Europe the only schools that could call themselves rivals were the London Business School (LBS) and IMD in Switzerland. Its one-year MBA course is still famous for the experience of mixing with students from a wide range of countries. Internationally, it holds its head up with the top American schools, and its 33,000 alumni form a powerful network covering the top echelons of global business. But now the heat is on for INSEAD, as a crowd of rivals has come forward, including a new, generously funded school in Berlin.

HEC, the original French business school in Paris, with a proud 127-year history, now tops the latest *Financial Times* ranking of European schools, ahead of both INSEAD and LBS. In another ranking of the world's top 100 business schools by the Economist Intelligence Unit* (a sister company of *The Economist*), INSEAD comes 17th. That puts it behind seven other European institutions, including Barcelona's IESE, Madrid's Instituto de Empresa and Cambridge University's Judge Business School, which all make it into the top 15.

One INSEAD insider says that the school is “rattled” by the latest rankings and by all the new competition. The school is obsessed with rankings, says an employee. Much management time goes on “gaming” the ratings to ensure a good score. The EIU rankings are based on student surveys asking about career openings, the overall educational experience, salary effect and networking potential. Those of the *Financial Times* look mainly at return on investment, in terms of the boost to a salary. Soumitra Dutta, dean of external relations at INSEAD, says that rankings “are not always most helpful” because of all the different methodologies used. In other words, they are a nuisance.

This week 30 executives from 13 different countries are entering their fourth month of the first executive MBA course at the European School of Management and Technology in Berlin (ESMT). Germany only got round to founding an international business school in 2002, and started small MBA classes two years ago. To be sure, a class of 30 students is puny compared with the 920 going through INSEAD this year. INSEAD's joint campus (it runs a parallel school in Singapore), has 143 teachers compared with ESMT's 22. But the infant German institution has the financial support to triple the size of its faculty within five years. Its backers span the alphabet of leading firms from Allianz and Axel Springer through BMW, Bayer and Bosch to Siemens and ThyssenKrupp. The president of ESMT is Lars-Hendrik Röller, a former INSEAD professor with a distinguished academic career on both sides of the Atlantic. He says the strength of the new school will be business and its interaction with technology and public policy.

INSEAD also had money on its mind when it appointed a new dean in 2005. Frank Brown is an American and a former partner in PricewaterhouseCoopers. A former INSEAD board member, his brief as dean was to raise more finance for a school that has always struggled against the financial heft of the Americans. So far, says Mr Dutta, he has already raised some €170m of the €200m which the school wants to find by 2010.

INSEAD, LBS and IMD face new threats beyond uppity rivals like the Spanish schools and the universities of Oxford and Cambridge (both late to embrace business, but rich and rising fast). The forthcoming harmonisation of European university education, under what is known as the Bologna Accord, could also upset them. Europe's universities will soon all adopt a uniform Anglo-Saxon system of bachelors, masters and doctoral degrees. This is designed to produce greater movement of students around Europe, and has already generated 299 new management masters degree courses that students can follow straight after an undergraduate degree. It was HEC's success in these courses which helped it beat all the other business schools in the *FT* rankings. INSEAD and the other established names no doubt look down their noses at them—but perhaps at their peril.

* Which MBA? 2008. Economist Intelligence Unit, London

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Wireless industry

Airwaves for sale

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Is the last big chunk of radio spectrum worth bidding for?

LET the bidding begin. The day *The Economist* went to press, America's Federal Communications Commission (FCC) was expected to raise the hammer on a much-awaited auction of a big slice of radio spectrum. Rarely has an auction of spectrum been so closely watched. But the excitement may not be justified.

The sale is certainly more than just another spectrum auction. For one thing, the 700-megahertz band has correctly been called the last “beachfront property” in the ether: it is well suited to the sort of bandwidth-hungry services that will generate much of the wireless industry's growth. Radio waves in this part of the spectrum travel far and can pass through thick walls. And this will be the last big chunk of spectrum to be auctioned for a long while. It is being returned by TV broadcasters, which are switching to digital in February 2009.

Second, the biggest block of bandwidth to be sold comes with novel conditions attached. Today a few big carriers, such as Verizon and AT&T, dominate America's wireless industry and control which devices and applications can be used on their networks. But with the spectrum on sale this week, licence-holders will have to accommodate any mobile device or type of service, provided it does not harm the network. With these “open-access” provisions, the FCC wants to create space for more innovation.

Google is the third reason that this auction is different. The open-access provisions are mainly the result of the online giant's lobbying. Google has vowed to bid at least $4.6 billion. It is not just defending the consumer's interests, but its own: the auction is part of a larger battle over how revenues from wireless advertising and services will be divvied up between the carriers and Google.

Still, on all three levels the auction could be disappointing. Because of the turmoil in financial markets, even the biggest bidders may have difficulties raising the necessary cash, meaning that the auction may not generate much more than $10 billion, the sum of all the reserve prices. In addition, the open-access provisions may not go far enough. In Europe similar rules already apply and have not produced much more choice in devices and applications. Much will depend on how future licence-holders enact the provisions.

As for Google, it will not mind all that much if it loses. Were it to win, it would have to raise billions more to build a wireless network and would probably need to find a partner, which would be a departure from its practice of piggybacking on other people's infrastructure. Most analysts expect Google to bid just enough to make sure the open-access provisions apply (the FCC has said it may re-auction the spectrum without the open-access provisions if the reserve price is not met).

How much does it matter whether it is Google, another outsider, or one of the incumbent carriers that wins the spectrum? Probably not a great deal. More open wireless networks seem sure to come about, in America and elsewhere. Technology is heading in that direction—and consumers want openness, as the backlash against Apple, a computer-maker, and its locked-down iPhone handset has shown. One day, with luck, wireless networks will be as open as the internet.

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Chinese hotels

Room at the inn

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Busy people in the hyperactive Chinese economy need a place to rest

IN 1999 Ji Qi founded Ctrip, a new internet firm, and hit on a vast, untapped area of demand: the Chinese traveller. This was someone who had formerly been too poor and too fenced in by government rules to move around even one of China's 22 provinces, let alone the whole country. After the online travel agency came Home Inns, an equally successful chain of basic hotels. Nine years later, Mr Ji is on his third company for travellers: Hanting Hotels. Even as China's dynamic exporters are stumbling over rising costs and deteriorating overseas markets, these three firms are growing at ferocious rates by catering to domestic demand.

Hanting Hotels is less than three years old but already has 75 outlets. Occupancy averages 90%, after being open for just three to four months, says Mr Ji. His customers are Chinese businessmen, a hardy, self-sufficient bunch who want clean rooms, a desk, a television and internet service and are not fussy about pools, minibars or any other fluff. Room prices are modest—under $40 a night. A second brand, Hanting Express, will soon be launched with prices from $15 to $30 a night, aimed at non-business travellers, with even more austere fittings. Mr Ji says he will have 1,000 outlets within three to five years.

Other companies in the low-cost travel business are doing well too—though not many have the scale to match Mr Ji's empire. Behind their success is a change in China itself. Tens of millions of people are travelling long distances for the first time, thanks to millions of new cars and investments by the government in roads, railways and airports. Most cheap hotels are wretched. They are often run by the local government or a state-owned company. It is not uncommon to end up in a hotel with occasional heating, cigarette ends ground into the carpet and a “foot massage” room off the lobby that is really a brothel.

When Mr Ji founded Ctrip, the government's desire to keep a hold on the movement of people and money meant there were no automated payment systems and no private travel firms. Ctrip had to find ways around this—many people, for instance, do not have credit or debit cards and want a real ticket, not an electronic one. Ctrip sends out motorcycle couriers to take their cash and deliver tickets. “It did a remarkable job of being flexible enough to address gaps in the market,” says David Michael of the Boston Consulting Group.

Revenues at Home Inns are growing at more than 70% a year and its net income is rising faster still. Its shares are valued at more than 100 times last year's earnings, and that attracts competition. Super 8, an American brand of hotels, has come into the market, as has a domestic firm, Motel 168, and a handful of others. More will arrive soon and the country's travellers will benefit. Export markets may be slowing, but domestically China is on the move.

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Face value

High Streiff

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Reuters

Has Europe's newest car boss learned the lessons of a confrontational past?

WHEN Christian Streiff arrived at PSA Peugeot Citroën in late 2006 after a remarkably short reign at Airbus, employees looked for clues about their new boss in a novel he had penned six years earlier. In “Kriegspiel”, which tells the story of a French company doing business in East Germany following the fall of the Berlin Wall, one of the more sympathetic characters observes: “Humility is a more important quality than courage.” But what has characterised most of 53-year-old Mr Streiff's career is boldness and a bullish impatience to get things done.

During his 26 years at Saint-Gobain, a large building-materials firm, Mr Streiff became the company's turnaround specialist—the man sent to sort out an ailing subsidiary because he could be relied upon to act quickly and ruthlessly. After restoring the fortunes of Gevetex, Saint-Gobain's German glass-fibre maker, he was sent in 1991 to run its Italian glass-containers subsidiary. He is proud of his three years there: “I was not just a cost-killer,” he says. “The headcount decreased by 25%, but volume went up by 30%.” Christian Durieu, one of the union leaders he dealt with, recalls that the baby-faced Mr Streiff had a “touch of brutality” about him, but he always acted “with a smile”.

In 2004 Mr Streiff got his reward. He was promoted to chief operating officer and officially recognised as the heir apparent to Jean-Louis Beffa, Saint-Gobain's chairman and the grand old man of French industry. A year later, he was on his way out of the company. There was talk of strategic differences and having lost the confidence of the board. But it is believed that Mr Beffa thought that Mr Streiff was trying to push him out before he was ready to go. Mr Streiff says that perhaps he was too focused on results and not enough on his relations with the chairman.

Mr Streiff spent the 14 months before landing the top job at Airbus qualifying as a dive master and reflecting on the lessons he had “learnt the hard way” at Saint-Gobain. He now concedes that the lesson was not complete. Mr Streiff should have known that running Airbus would require political skills of a high order; the firm is owned by EADS, a peculiar entity in which the core shareholders represent the interests of the French, German and Spanish governments and which, until July last year, was saddled with a joint chairmanship and joint chief executives. Mr Streiff took over in the midst of crisis. The manufacturing faults that had delayed the delivery of the A380 superjumbo were threatening the future of the company, and the proposed A350, designed to take on Boeing's new 787, was a plane that nobody wanted. With the weak dollar adding to the problems at Airbus, Mr Streiff decided that there was no time to lose. Describing his first few days as “vertical take-off” at “full thrust”, he threw himself into the job of saving Airbus, as he saw it, from itself.

Much of the “Power8” restructuring plan that Mr Streiff put together with speed and energy during his 100 days at Airbus survived him. But his demand for managerial autonomy, including the right to recruit his own team without regard to the political balancing act at EADS, trampled over too many interests. The Germans, who had originally pressed for his appointment, feared they would suffer the brunt of the cuts. A confrontational visit by Mr Streiff to a factory in Hamburg (where the A380's cabling problems had originated) left people shocked and angry. The EADS board told him that his behaviour was not acceptable. “Some people,” grumbled Mr Streiff, “are not accustomed to hearing the truth.”

With a lifeline on offer from PSA, Mr Streiff grabbed it before he was pushed. He claimed that his plan had been undermined by the dysfunctional corporate governance at Airbus. But the more emollient Louis Gallois who succeeded him showed what could be done even in less than ideal circumstances, and Mr Streiff now admits he could have been more diplomatic.

There is plenty of potential for similar problems at PSA. The Peugeot family controls 45% of the voting rights and is well represented on the supervisory board. When Mr Streiff was hired, Robert Peugeot also sat on the executive board as head of innovation and quality—two areas the new boss marked out in his first three months for improvement. But this time everyone handled themselves with tact. Mr Peugeot gracefully stepped away from his executive role at the firm, while Mr Streiff sensibly gave himself time to get to know the business and its people before charging in.

What he found was a sound company that had begun to lose its way in 2004, after more than a decade of success. PSA was over-reliant on just three cars and its popular light vans. The average age of the model line-up had risen to 4.2 years—old by the industry's standards. Margins and market share were slipping and the quality of PSA's vehicles had failed to keep pace with that of its rivals'. In short, the business had become sluggish.

Pedal to the metal

Mr Streiff's prescription is speed. Everything the company does must happen faster, he says. He has set himself the goal of more than doubling margins to around 6% (respectable for the car industry) before the end of 2010. He has promised to slash indirect costs by a third; double the quantity of materials sourced from low-cost countries; shorten development cycles by a third; lower fleet average age to three years; engineer a step-jump in quality; expand production in emerging markets. When PSA announces its full-year results next month, it is expected to show an improvement in its operating margin for the first time in four years.

There is certainly no doubting Mr Streiff's effectiveness when it comes to managing down. What he still needs to prove is that he has learned to manage up. At PSA, that means not just getting results from the business, but also earning the trust of the Peugeot family. So far he seems to be doing just that, but he cannot afford to get it wrong again.

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Commercial space flight

Starship enterprise: the next generation

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A fleet of privately financed spaceships is emerging. It heralds a new business in space travel

Virgin Galactic

THE way Will Whitehorn tells it, the story began in 2003 in Mojave, California, on a visit to Scaled Composites, a company with a reputation for designing and building futuristic and sometimes wacky-looking aircraft. Mr Whitehorn is one of the top brass in Sir Richard Branson's Virgin Group; and Virgin Atlantic, Sir Richard's airline, was sponsoring *Global Flyer*, a Scaled Composites creation, on a non-stop voyage around the world. On his way out of the factory Mr Whitehorn saw something unusual and asked what it was. Burt Rutan, head of Scaled Composites, told him it was a spaceship. He was building it for another customer, but he couldn't say any more.

Mr Rutan's customer turned out to be Paul Allen, one of the founders of Microsoft. When *SpaceShipOne*, as the craft was called, reached space for the second time, on October 4th 2004, it won the $10m Ansari X Prize. The craft was taken to high altitude by *White Knight*, a more-or-less conventional aircraft, and then dropped, whereupon its engines ignited to shoot it 100km (60 miles) above the planet, and thus officially into space. After a short flight it re-entered the Earth's atmosphere and glided down to land on a conventional runway. Manned space travel thus moved from the realm of governments to private enterprise.

However, Mr Allen was interested only in proving that the spaceship technology would work, not in exploiting it commercially himself. That left Mr Rutan with a very cool spaceship on his hands, but no way of making money from it. Mr Whitehorn and Sir Richard were intrigued. Virgin Galactic, a company in the Virgin stable and which was headed by Mr Whitehorn, decided to license the technology for *SpaceShipOne* and *White Knight*. Virgin Galactic said it wanted to offer commercial sub-orbital flights to paying passengers by the end of the decade.

Virgin Galactic has since accumulated a number of commercial rivals in the space-tourism market. One of them is Jeff Bezos, the founder of Amazon.com, who is building a competing sub-orbital spaceship at a ranch in Texas. His space company, Blue Origin, is so secretive that it will not even answer questions about its logo.

But Virgin Galactic has passed an important milestone. At an event held at the American Museum of Natural History in New York, on January 23rd, the company unveiled the design of its new generation of vehicles, and said that the first examples had almost been finished at Mr Rutan's factory. *White Knight Two* is due to begin test flights towards the middle of 2008, but may roll out of the hangar in the next few weeks. Test flights of *SpaceShipTwo* itself could start towards the end of the year.

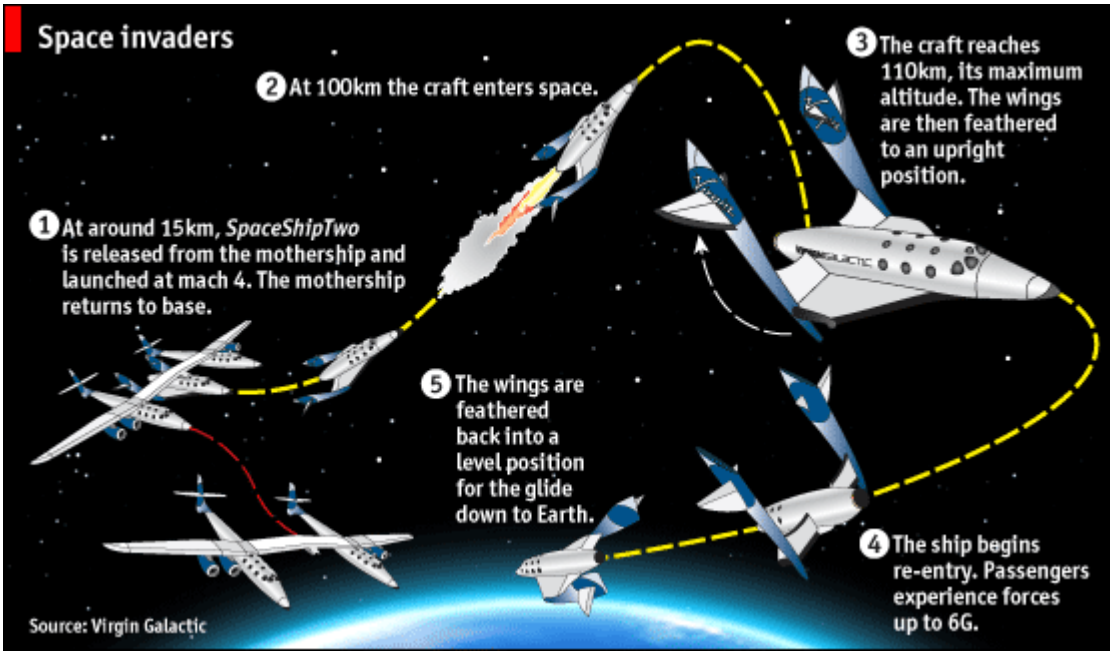
Fly me to the moon

The combination of a carrier aircraft and a spaceship to get into space is akin to building a two-stage rocket. Air-launched rockets have a long history. *SpaceShipOne* and *White Knight* were, in essence, vastly improved and much cheaper versions of the X-15 rocket plane that set speed and altitude records in the early 1960s and the B-52 bomber that carried the rocket plane under its wing. But pure rockets, such as the ones that lift the space shuttle, won out because the Space Race between America and Russia emphasised speed over cost, and rockets were proven technology, having already been developed as intercontinental ballistic missiles. However, they consume a huge amount of power as they claw their way up through the Earth's thick atmosphere. By contrast a rocket lifted by a plane with wings before being launched can be made much smaller and lighter. The plane itself is light because its engines breathe air. It thus needs to carry less fuel than a rocket, and no chemical oxidant to burn that fuel, as a rocket would. Each craft—plane and rocket—can therefore be optimised for its own job, which is easier than designing a single vehicle that has to make lots of compromises to do both.

Lifting more

Virgin Galactic's second generation of craft are based on *SpaceShipOne* and *White Knight*, but with plenty of differences. *White Knight Two* has been redesigned wholesale to lift a much larger spaceship with eight people on board instead of three. It has a wingspan equivalent to that of a Boeing 757, is three times larger than its predecessor and is the largest aircraft made entirely from composite materials like carbon fibre. It is powered by four Pratt & Whitney engines. With its twin boom and long wing, it looks more like the *Global Flyer* than its predecessor. It has also been engineered to be able to treat any passengers it carries to zero-gravity swoops on the way down after they have watched the spaceship being released for its trip into space.

SpaceShipTwo itself will accommodate two pilots at the front and also six passengers, who will have room enough to bounce around in zero gravity. It has more of a dolphin-like nose than its prototype and more windows. It will also go a little higher than its predecessor, so that its passengers will experience five minutes or so of weightlessness before flying back to receive their astronauts' wings. But, crucially, it has the same flip-up wings. These are used when the craft reconfigures itself for re-entry into the Earth's atmosphere. The wings rotate through 90° to give it extremely high drag, which allows it to begin its slow deceleration through the atmosphere earlier and at higher altitudes than previous spaceflight re-entries.


Space invaders
1 At around 15km, SpaceShipTwo is released from the mothership and launched at mach 4. The mothership returns to base.
2 At 100km the craft enters space.
3 The craft reaches 110km, its maximum altitude. The wings are then feathered to an upright position.
4 The ship begins re-entry. Passengers experience forces up to 6G.
5 The wings are feathered back into a level position for the glide down to Earth.
Source: Virgin Galactic

The spaceship will be fuelled by a “hybrid rocket”—so-called because it contains both liquid and solid propellants. These rockets can be cheaper to develop and operate, and the fuel is safer to store than in purely liquid-fuelled ones. *SpaceShipOne* used rubber and laughing gas. Scaled Composites is studying alternatives to rubber that may offer better performance.

Another change in the design of the spaceship is the insertion of a flexible glass-fibre section into its composite structure. This will allow the rocket's oxidiser tank to expand when it is full. All these changes mean that when *SpaceShipTwo* does begin flight tests, the programme will last at least a year before paying customers can take to the skies.

Work will also begin soon on fitting out another factory to start making more of these craft. Virgin Galactic has ordered five spaceships and two carrier aircraft. The spaceships will take longer to refuel for their next flight than the carrier aircraft do, so—thinking just as an airline would—the firm has concluded it needs more spaceships than carriers. Each spaceship should eventually be capable of making two trips into space every day, and the launch aircraft three or four flights. Mr Rutan says they could operate from a number of airports and spaceports around the world.

Virgin Galactic believes the fleet it has ordered should be large enough to furnish its space-tourism business in the early years. Trips are expected to cost some $200,000 each to start with. Hundreds of people have put down a total of $30m in deposits. However, as the firm also made clear at the announcement in New York, the new craft may one day do a lot more than ferry day-trippers to the edge of space and back. Stephen Attenborough, Virgin Galactic's commercial director, says the spaceship is revolutionary because it is able to take not just people into space, but other payloads too.

Up, up and away

What those other things will be is still unclear, but satellites are a possibility. Virgin Galactic says it thinks it could launch small satellites in the range of 50-100kg into low-Earth orbit using an unmanned rocket hung from *White Knight Two* for less than $2.5m. The market for launching small satellites is presently only partly served by the Pegasus rocket, which is launched at high altitude by a commercial jet aircraft. But a launch using Pegasus would cost many times the price that Virgin is talking about. If costs are brought low enough it could make even tiny satellites financially viable. These could be sent up by all sorts of organisations, including universities for research projects.

An air launch is constrained by the weight the carrier aircraft can lift, so big rockets blasting off from the ground will, for the time being, remain the only way to get the heaviest payloads into space. It is possible for small satellites to hitch a ride along with big payloads, but that can be difficult to arrange and is much more restrictive than having a dedicated low-cost launch vehicle like *White Knight Two*. Virgin Galactic is already having discussions with a company interested in creating a rocket that would launch satellites from *White Knight Two*.

Launching at high altitude has many advantages for space tourists and commercial loads alike. Using an aircraft to take up a rocket can avoid the numerous weather-induced delays—and costs—that get in the way of rockets fired from the ground. Aircraft can climb above bad weather to a more suitable launch position. Nor do they need specially built, reinforced launch pads. Any suitable runway will do.

In addition, an air launch promises a lot more scope to find a good “launch window” to get the spacecraft into orbit. Launching from the ground can mean waiting for the Earth to rotate until the launch window is accessible. But an aeroplane carrying a rocket can fly to the window instead.

Air launches are also a greener way of getting into space, because they avoid igniting rockets in the lower atmosphere. Earlier this month Virgin Atlantic said it would fly one of its Boeing 747s using biofuel during a demonstration flight in February. Mr Attenborough says this has “implications” for *White Knight Two*, which indicates that the company is also looking at greener fuels for the carrier aircraft.

Who knows if the moon's a balloon?

In the longer term Virgin Galactic's system could also be used to launch hypersonic vehicles, which could dash from one side of the world to the other in a few hours. In 2005 and 2006 *White Knight* test-launched the American government's experimental X-37 hypersonic plane. America's space agency, NASA, has signed an agreement with Virgin that covers co-operation on the planes. The company is also said to be discussing a third, more powerful generation of spaceships, designed to make longer sub-orbital journeys rather than just poking their noses into space in the way that *White Knight Two* will.

Mr Whitehorn and Mr Rutan have made no secret of their desire to see later generations of carrier aircraft

and rocketry that can put people into orbit. Some within the industry are sceptical that Mr Rutan can develop such vehicles, which will have to travel many times faster than a sub-orbital plane and must have tougher heat-shielding in order to survive harsher re-entry. Nevertheless, business is taking an increasing interest in the possibilities and last year Northrop Grumman, a big aerospace and defence contractor, increased its 40% stake in Scaled Composites to 100%. Mr Rutan expects Scaled Composites to build 40-50 launch aircraft. He thinks that at least 15 will be used for space tourism, with the rest used for satellites and other payloads.

As the new generation of craft emerges, so will new ideas about their capabilities and potential. With some $70m already spent and another $130m still to come, Mr Attenborough says that Virgin Galactic expects to break even in 2014. Reducing the price of a trip into space to attract more customers is also part of the plan, as is exploiting every possible form of additional income, such as selling media rights.

Finding new markets for its carrier ship will help Virgin Galactic make money faster. Mr Whitehorn believes that wider use of the vehicle will ultimately come with lifting payloads and satellites into space. Although the customers for such launches are not yet putting down their deposits, the progress to commercial space flight—complete with a business plan and a profit goal—is nonetheless remarkable. There are surely easier and safer ways for businessmen like Sir Richard, Mr Bezos and others to make money. Then again, commercialising space is a venture for the unconventional.

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Spaceflight medicals

Suited for space

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Can humans cope with the final frontier?

PEOPLE did not evolve for space flight, so how will they cope when the tickets go on sale? It will be a wild ride, but one that a surprisingly large number may enjoy. Many of Virgin Galactic's early customers have been put through a human centrifuge to find out. This tests their reactions and tolerance to the forces that they would experience on a sub-orbital trip. That includes dealing with G-forces 6.5 times that of Earth's gravity and mostly they coped very well.

Human centrifuges featured in both “Moonraker” and “The Right Stuff”. The machines in those films were basic: a seat on the end of a metal beam. Known as “iron maidens”, they are medieval compared with the kit at the National Aerospace Training and Research Centre (NASTAR) in Southampton, Pennsylvania, which opened last year at a cost of $25m. The centre can simulate gravitational forces in any direction in its “dynamically positioned gondola”—a fancy way of describing a cabin that can face in any direction and is attached to an arm spinning around a central point.

The victims—sorry, customers—are strapped in as they watch a wide screen simulating the view into space. To the rear is another screen showing the receding Earth. With this, NASTAR is able to recreate any kind of space launch. Glenn King, of NASTAR, says the company usually trains fighter pilots, but it has also trained a few people who have paid to visit the international space station.

The simulation of forces likely to be experienced on the new Virgin Galactic spaceship suggests more people than had previously been imagined would be able to endure the trip. The accepted view was that only the fittest could withstand six Gs through the chest and 3.5Gs from head to toe. The second, smaller force, is tougher, because it pushes blood downwards and away from the head, sometimes leading to unconsciousness. Nevertheless, the passengers who tested well at NASTAR included a 77-year-old woman and James Lovelock, a scientist and author, who is 88.

Some people did need a trip to the doctor before going for a spin. In these cases doctors looked for abnormalities, like an unusual heart rhythm. Unknown health problems are more of a threat than known ones. But even some who had health problems were able to go ahead, says Mr King. Of the 80 potential passengers, two were advised by their doctors not to take part and three were asked to come back after more training.

NASTAR reckons that more than 90% of the population could handle a sub-orbital flight. Nor does Mr King see any reason why children as young as five or six could not go too. Air sickness should not be a problem. Virgin Galactic's Will Whitehorn says that one operator of zero-gravity aeroplane rides has virtually eliminated the vomiting, thanks to a combination of “diet, drugs, training and methodology”. No reason then, short of a few hundred thousand dollars, not to book a flight right now.

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Bond insurers

Buddy, could you spare us $15 billion?

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Another shady realm of finance goes begging for a massive bail-out

Illustration by Satoshi Kambayashi

THIS has been a crisis of risk in unexpected places. Think of collateralised-debt obligations (CDOs), structured investment vehicles (SIVs), and now a £4.9 billion ($7.1 billion) loss due to fraud at Société Générale. One particular nastiness has been festering in an obscure industry which, until recently, enjoyed pristine credit ratings: the "monoline" bond insurers. Their plummeting fortunes (see chart) helped to spark the stockmarket sell-off that prompted the Federal Reserve to act this week ahead of its scheduled meeting.

So perturbing was their plight that the prospect of a rescue caused a far bigger stockmarket rally than the Fed's biggest rate cut in a quarter of a century the day before. There may be no better example of how a dull province of finance, when snared by complex risks it barely understands, can become terrifyingly unboring.

Though themselves no giants, monolines have guaranteed a whopping $2.4 trillion of outstanding debt. The two largest, MBIA and Ambac, cut their teeth "wrapping" municipal bonds, in effect, renting their AAA rating to the securities for a fee. For a long time this business, though staid, was nicely profitable.

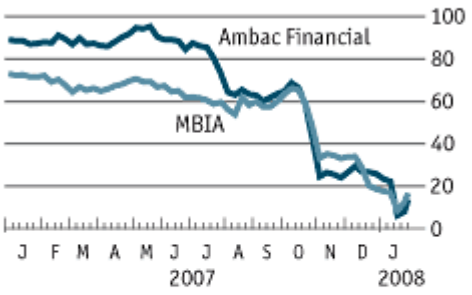
But, as competition grew, the monolines—with two honourable exceptions, FSA and Assured Guaranty—were seduced by the higher returns of structured finance, especially the stuff involving subprime mortgages (see table). As mortgage delinquencies rose, so did paper losses. Ambac and MBIA wrote assets down by a combined $8.5 billion in the past quarter.

The monolines' thin capital cushions, adequate when they wrote only safe municipal business, now look worryingly threadbare. Moody's and Standard & Poor's—the very rating agencies the monolines relied so heavily upon when piling into the mortgage business—are threatening downgrades unless they raise more equity. Ambac's failure to do so last week prompted Fitch, another rating agency, to cut its debt by two

Caught in the honey trap

Bond insurers

Share prices, $



Subprime exposure, latest, $bn

	Direct (mortgage-backed securities)	Indirect (CDOs)
Ambac	8.8	29.2
MBIA	5.1	25.3
Assured Guaranty	6.7	0.42
FSA	4.8	0.36

Sources: Thomson Datastream; CBM Group

notches, to AA.

This has spooked investors for several reasons. First, heavily downgraded insurers would lose their *raison d'être* and thus face the prospect of selling up or going into “run-off”: closing to new business and gradually winding down.

Worse, from a systemic point of view, when a monoline is downgraded all of the paper it has insured must be downgraded too. Hence, after its move against Ambac, Fitch went on to cut no fewer than 137,500 bonds (including one issued by Arsenal football club).

This is more than academic: holders of downgraded bonds have to mark them down under “fair value” accounting rules. Some, such as pension funds, may hold only the highest-grade securities, raising the prospect of forced sales. And, with fewer top-notch insurers to turn to, bond issuers' costs would rise. The loss of the AAA badge would cost investors and borrowers up to $200 billion, reckons Bloomberg, a financial-information firm.

Banks that were active in asset-backed markets have multiple reasons to worry. Many not only used monolines to wrap their products but also bought protection from them through credit-default swaps (CDS). One insurer, ACA, has already had problems paying out, prompting Merrill Lynch to write down its exposure to the firm by $1.9 billion. Meredith Whitney of Oppenheimer has calculated that banks may have to write off $10.1 billion of the paper they insured with ACA.

Because the CDS market is barely regulated, it is impossible to know how much of this monoline “counterparty risk” banks are exposed to. In many ways, ACA was an outlier: with a rating that never rose above single-A, it targeted inferior bond issuers (whom its boss once described as “the cream of the crap”). But downgrades could leave others struggling to pay out on policies too.

Monolines have a tiny percentage of the CDS business, according to the Bank for International Settlements. But the market is so vast that this still amounts to $95 billion of protection, most of it sold to banks. If Merrill Lynch is a guide, fully half of Wall Street's subprime and CDO hedges were booked with monolines, says Brad Hintz of Sanford Bernstein. As the risk of MBIA and Ambac defaulting has grown, he adds, so has the cost of holding once valuable hedges with them.

A lifeline for the monolines

No wonder, then, that a group of banks is giving ear to a request from New York' s insurance regulator, Eric Dinallo, who oversees some of the big monolines, to discuss a possible rescue. In preliminary talks held on January 23rd, Mr Dinallo reportedly asked the banks to stump up as much as $15 billion to help MBIA and Ambac preserve their ratings.

The regulator, who apparently has the blessing of federal officials, is talking to other potential investors too, said to include Wilbur Ross, a vulture investor, and Warren Buffett's Berkshire Hathaway, which recently set up its own bond insurer and has not ruled out buying part of a troubled rival. These veterans believe the business has a future, despite its woes. That is because they understand that, on the municipal side at least, the market has always demanded a much higher spread than the actual cost of risk, points out CBM Group's André Cappon. Clever guarantors can exploit this gap.

It remains unclear how any bail-out would be structured. One possibility is to create the equivalent of “bad banks”, ringfencing the monolines' tarnished CDO operations to allow their municipal businesses to continue unencumbered, or be sold. This would also assuage fears that mishaps in securitisation might bring down the public-finance markets, says Janet Tavakoli, a consultant. Another idea would be to create a so-called “excess-of-loss pool” that would allow the monolines to reinsure their nastiest tail risks.

Banks have reasons to pause before taking part. They have seen a Treasury-backed bail-out of SIVs wither for lack of interest, and they are not exactly flush with capital. But it may be a bet worth taking, however gingerly. Even if $15 billion were needed, that is thought to be a lot less than their (undisclosed) total exposure to the monolines. A painful contribution now looks preferable to another agonising round of write-downs later this year.

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Global markets

A wild ride

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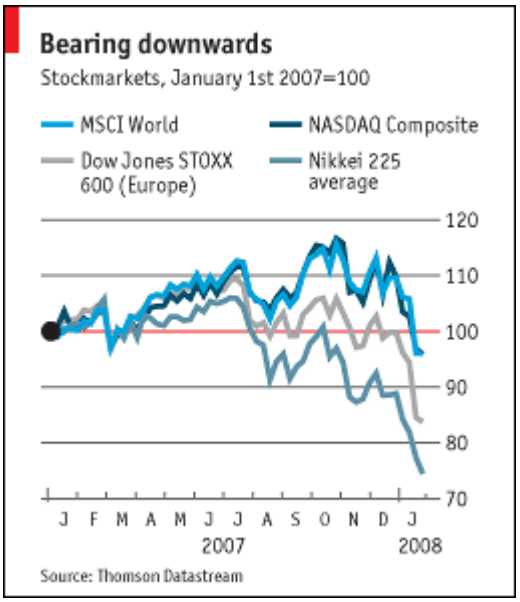
From The Economist print edition

There will be odd rallies, but fear will continue to stalk the financial markets

JAMES CARVILLE, Bill Clinton's political adviser, once said he wanted to be reincarnated as the bond market so that he could “intimidate everybody”. This week the stockmarkets showed they could make pretty good use of the knuckle-duster, too.

It did not even take a fall on Wall Street to spook the Federal Reserve into slashing interest rates by three-quarters of a point on January 22nd; the American markets were closed for a public holiday the day before. The Fed reacted instead to a slump in global markets and the prospect, indicated by the futures market, that the Dow Jones Industrial Average would drop by more than 500 points at the opening. Small wonder that traders are now talking about the “Bernanke put”—the idea that, like his predecessor, Alan Greenspan, the Fed chairman will ride to the rescue whenever markets falter.

On January 23rd the markets chalked up another success when, after driving down the share prices of the two largest bond insurers to the point where they threatened to buckle, the prospect of a rescue surfaced. It came just in the nick of time. Half way through January 23rd, many global stockmarkets, including America's NASDAQ, were at least 20% below their peaks, a decline that put them in bear-market territory (see chart). World stockmarkets, as measured by the MSCI, were almost there. Despite its recovery on January 23rd the S&P 500 was still down 14.5% from its peak in October.



The markets have pulled out of such swallow dives before, notably in 1998 when rate cuts revived sentiment in the wake of the Asian crisis and the collapse of Long-Term Capital Management, an American hedge fund. Whether the latest recovery marks a turning point, or merely a pit stop on the way to a bear market, depends on whether the Fed has moved sharply and deeply enough to save America from recession. It also depends on how the rest of the world reacts to America's woes (see article, article, article).

There are plenty of reasons for pessimism. The credit market, which has been a better gauge of the credit crisis than shares, is still sickly. As of January 23rd, the cost of insuring against default by European speculative bonds had risen by almost one-and-a-half percentage points over the previous month (see chart).

The credit crunch continues to sap the strength of the financial system, which may curb banks' ability to lend. By flooding the money markets with liquidity near the end of last year, central banks helped unjam the troubled interbank market. But a year after subprime-mortgage woes started to emerge, house prices are still falling and investment banks are owning up to ever larger write-offs on mortgage-related investments.

If the problems are still largely focused on the subprime-mortgage market, they are not safely quarantined in the United States. Before the year started, investors had taken comfort from the concept of decoupling—that the rest of the world, and particularly Asia, could keep growing

regardless (see article). Generally, much of the world, particularly emerging Asia, is less exposed to America than it was. However, the slide in the Baltic dry index of shipping rates could be an indicator of falling global trade volumes (it may also reflect extra shipping capacity). And commodity prices (including oil) have slipped on fears the global economy is slowing.

Emerging markets, which had yielded much better returns than the developed world did in 2007, have also been dragged down since the start of the year. And riskier currencies have lost ground to the relative security of the Japanese yen and the Swiss franc.

Never satisfied, futures markets are betting that the Fed will cut rates again when policymakers meet at the end of the month. Would another half a percentage point be enough to stop the rot? One salutary thought, according to Teun Draaisma of Morgan Stanley, is that on the 15 occasions since 1970 when the Fed has cut rates by 75 basis points or more, the average gain for European stockmarkets over the following six months has been 10.3%. Fredrik Nerbrand of HSBC Private Bank thinks markets are due for a rebound because the selling has become so indiscriminate.

But even if rate cuts bolster confidence, they may not come soon enough to stop corporate profits tumbling. According to Tim Bond of Barclays Capital, the recent falls in American and European share prices imply a 20% or so drop in profits from their cyclical peak. That is close to the average decline in previous profits downturns. However, this cycle has been more extreme than normal; profits recently reached a 40-year high as a share of American GDP. They thus have further to fall if they are going to return to the mean.

The dismal dollar

Also, the Fed's actions do not just have an effect on share markets. Alan Ruskin of the Royal Bank of Scotland says that rapid rate cuts mean the dollar risks becoming a funding currency for the “carry trade”, rather as the ill-starred Japanese yen has been. (The trade involves borrowing in a currency with low interest rates and investing the proceeds in a currency with higher rates.) Mr Ruskin says that the gap between 12-month dollar and Swiss-franc rates is already as low as it was in the last cycle, when the Fed cut rates to 1%. “By the end of this cycle, dollar short-term rates will be lower than all 40 liquid currencies except the Japanese yen and Hong Kong and Taiwanese dollars.”

If the dollar becomes part of the carry trade, it will tumble even further. And a falling currency makes it harder to persuade foreigners to finance America's trade deficit. David Bowers of Absolute Strategy Research reckons the subprime crisis has “destabilised the symbiotic relationship between Asian and Middle Eastern savers and American consumers.”

Those foreign investors may also get spooked at the direction of Fed policy. They have seen the bank cut rates in response to last August's credit turmoil and now a January stockmarket plunge. They may start to feel that the Fed has turned from a watchdog against inflation into a labrador puppy. Thanks to the global slowdown, there is no short-term inflationary threat. But the longer-term risks have probably gone up. And, as James Carville discovered in the 1990s, the bond-market vigilantes can be powerful enemies if they feel neglected.

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Economist.com FINANCE & ECONOMICS

The Federal Reserve

Going it alone

Jan 24th 2008 | WASHINGTON, DC
From The Economist print edition

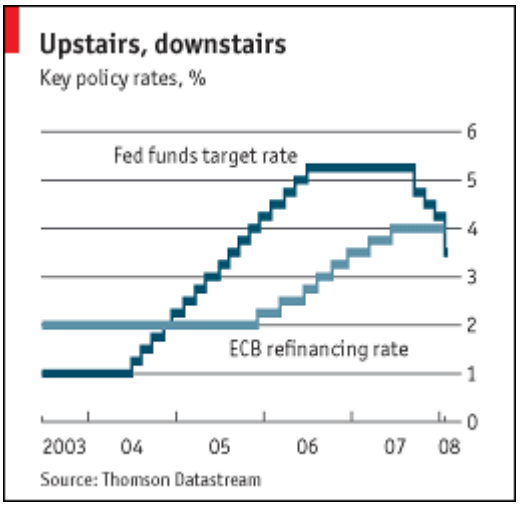
The gap between the Fed and other big central banks widens. For how long?

ALMOST as striking as the scale and timing of the Fed's rate cut on January 22nd was the coolness with which other central banks reacted. The Bank of Canada cut its short-term rates by a quarter point at a scheduled meeting the same day and some smaller central banks that peg their currencies to the dollar followed the Fed's lead. But no other big central bank did. The Bank of England said it had no plans to bring forward its next meeting, due on February 6th and 7th. Jean-Claude Trichet, president of the European Central Bank (ECB), went out of his way to squash market speculation that it, too, might soon cut rates. “Particularly in demanding times of significant market correction”, he said (to disappointment among investors), “it is the responsibility of the central bank to solidly anchor inflation expectations”.

At one level, this dissonance is no surprise. After all, it is America's economy that is tipping into recession. Britain has many vulnerabilities—with a big property bubble and highly indebted consumers—but its economy has not (yet) stalled in the way that America's has. Both in Britain and the euro zone, central bankers are worried about inflation and the prospect of a wage-price spiral.

But the transatlantic gap also suggests sharp differences in dealing with troubles in financial markets. It is striking that the Fed's rate cut came the day after a swoon in stockmarkets outside America (Wall Street was closed at the time for a holiday). America's central bankers, it seems, are more worried about tumbling shares in Europe than Europeans are themselves.

Few doubt that America's central bankers had room to cut. At 4.25%, short-term interest rates were somewhere around neutral, but monetary policy was hardly loose (see chart). As ever more figures suggested the economy was stalling, the Fed realised that it needed to step up the pace of loosening—a shift Mr Bernanke had made clear on January 10th. Financial markets were expecting a hefty rate cut on January 30th and several beyond.



It was the timing that raised eyebrows. One rationale was that an unscheduled cut a week before a regular meeting would allow the Fed to loosen rates faster overall. The central bankers' accompanying statement left the door wide open to more cuts, and financial markets are now expecting a further half-point reduction on January 30th. But the main reason for action this week was to forestall financial-market panic. Fed officials have made no secret of their worries about a “negative feedback” from financial markets to the real economy. They feared more bad news, such as the downgrading of bond insurance, could set off a nasty downward spiral. The risks of such a calamity made them think that waiting until January 30th was too dangerous. Given the global nature of financial markets, that logic suggests there was a case for co-ordinated international action. The trouble for the Fed is that other central bankers see things differently.

Whatever they think of its motives, the world's central bankers now face a Fed that is in full-scale cutting mode. And the chances are that other central banks will eventually follow suit. The Bank of England is widely expected to cut rates at its February meeting. For all Mr Trichet's protestations, the financial markets reckon the ECB will cut rates by the summer as Europe's output slows. If history is any guide, they will be proved right. Other central bankers may decry the Fed's alacrity at bringing cheaper money, but they usually join it in time.

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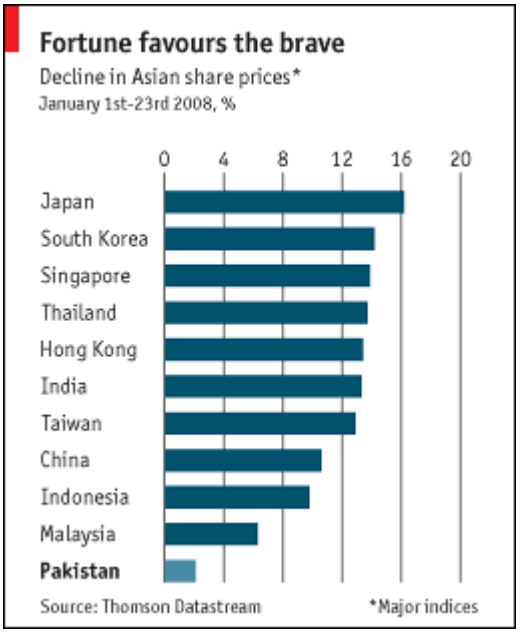
Pakistan's stockmarket

The world's most dangerous haven

Jan 24th 2008 | HONG KONG
From The Economist print edition

An unlikely bolthole for investors

THIS newspaper calls it “the world's most dangerous place”. Mark Matthews of Merrill Lynch calls it “the greatest information-arbitrage opportunity in the world.” He may be right. Since the start of the year, when Pakistan was reeling from the assassination of Benazir Bhutto, it has been the best-performing stockmarket in Asia (see chart). More evidence of madness in financial markets? Probably not. Its politics are bleak but the economy is expected to grow between 6.5% and 7% in 2008. Its companies continue, on average, to have a high dividend—4%—and a low price/earnings valuation—under 15 times. Perhaps its main salvation is the lack of foreigners in the market: that means fewer people to panic about the security situation—or the subprime situation back home.



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Decoupling 1: Emerging Asia

An independent streak

Jan 24th 2008 | HONG KONG
From The Economist print edition

Some investors fear that America's weakening economy will drag down Asia. In a series of related articles, we ask if they are right. First, the emerging countries

INVESTORS were until recently big fans of the "decoupling" theory, the notion that Asian economies can shrug off an American recession. This week's plunge in share prices, at one point taking the MSCI Emerging Asia Index down 25% from its October high, suggests they have changed their minds. But the fact that their stockmarkets are still coupled does not mean that their economies will follow America over a cliff.

Decoupling was always a misnomer if it implied that an American recession would have no impact in the East. Exports and hence profits would certainly be squeezed; some fear Japan may even be tipping back into recession (see article). Instead, the real argument in the rest of Asia was that it would suffer less than in previous American downturns.

As well as hitting exports, America's troubles could also affect emerging Asia through financial channels. Its exposure to the subprime mess is thought to be smaller than that of American or European banks. Even so, Chinese bank shares tumbled this week on reports that they would have to make bigger write-downs on their holdings of American subprime securities. And if shares slide further as global investors flee from risky assets, this could dampen business and consumer confidence in the region.

Some Asian economies are more vulnerable than others. Singapore, Hong Kong and Malaysia are the most exposed, with exports to America equivalent to 20% or more of their GDPs, compared with only 8% in China and 2% in India. There are already some ominous signs. Singapore's exports to America are down by 11% over the past year, whereas Malaysia's fell by 16%. Exports to other emerging economies and to the European Union surged, so total exports still grew by 6% in both economies. But that was much slower than at the start of 2007, and the worry now is that demand from Europe has started to flag.

The growth in China's exports to America slowed to only 1% (in yuan terms) in the year to December from over 20% in late 2006. So far the impact on GDP has been modest. Figures published on January 24th showed that China's GDP grew by a sizzling 11.2% in the year to the fourth quarter, down from 11.5% in the previous three months. Most economists expect growth to slow to a still-healthy 9-10% this year, but there are growing concerns that new government limits on bank lending risk choking the economy.

China's economy would probably still expand by around 8-9% even if export growth dried up. During the 2001 American recession China's GDP growth barely slowed. In contrast, Hong Kong, Singapore, Taiwan and Malaysia suffered full-blown recessions, with growth rates falling by more than ten percentage points from peak to trough. America's slump is likely to be deeper than in 2001 and Asia is now more integrated into the global economy than it used to be. Doomsters conclude, therefore, that these economies could be hit even harder this time.

The main reasons to be more optimistic are that domestic demand (consumer spending and investment) is likely to remain stronger and that governments have more flexibility to offset America's malaise. Last year, despite a slowdown in America's imports, most Asian economies grew faster as domestic demand sped up everywhere except Thailand. Robert Prior-Wandesforde, an economist at HSBC, says that those who argue that Asia cannot decouple from America are ignoring the fact that they already have. Take Malaysia: its exports to America plunged, yet its GDP growth quickened from 5.7% at the end of 2006 to 6.7% in the third quarter of last year.

Contrary to the popular view that Asia's meltdown during the 2001 recession was entirely due to a slump in exports, Peter Redward, at Barclays Capital, argues that a fall in investment played a bigger role. Too

much debt and excess capacity weighed down firms, particularly in the electronics industry, which was at the heart of the American recession. Today firms are in much better shape. Capacity utilisation is high across the region; outside China, investment as a share of GDP is historically low; company balance-sheets are stronger and real interest rates are low. Firms are therefore less likely to slash investment than in 2001.

Slowing exports will affect domestic spending. But macroeconomic fundamentals are much healthier in East Asia these days. Large foreign-exchange reserves make countries less vulnerable to shocks. Budgets are in surplus or close to balance, providing more scope for fiscal stimulus to support growth.

For all these reasons, even if Asia's exports clearly have not decoupled from America, its economies will be less hurt by a recession there than in the past. Standard Chartered forecasts that emerging Asia will grow by an average of 6.4% in 2008, down from 7.8% in 2007. In 2001 growth dropped by three percentage points, to 4.2%. Financial markets were slow to realise that growth and hence profits in some countries in emerging Asia will be dented by an American downturn. But now they risk exaggerating the potential damage.

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Decoupling 2: Japan

Unable to fend for itself

Jan 24th 2008 | TOKYO
From The Economist print edition

Japan's export-led economy still relies heavily on America

IN TOKYO'S financial markets a long-held sense of injustice is turning to rising alarm. The injustice is that the shares of Japanese companies were the first to be punished, long before other stockmarkets, when credit troubles in America broke out last summer. The alarm is partly over the effects that an American recession might have on the Japanese economy. But, equally, it is over a dysfunctional political establishment at home that is incapable of facing up to a weakening economy.

Pessimism is growing about the damage an American recession might do. Last year growth in exports to Europe and China more than offset an export slowdown to America. But the United States is still the end-market for many Japanese goods that go to China. A recent slackening of shipments of semiconductors and steel to China does not bode well.

If Japan's six-year recovery were broad-based, that would not be such a concern. Yet it has been pulled along by exports, and despite repeated predictions, household spending has failed to take off. The reason is clear: though employment has steadily increased, wages are stagnant or falling, since cash-rich companies insist on hoarding their profits—and will presumably continue to do so now that dearer oil is eating into margins.

Perhaps that hoarding is an insurance against unpredictable government. A year ago, in an attempt to crack down on predatory lending, the government all but destroyed the consumer-finance industry. Far more damaging has been a system for vetting new buildings that was hurriedly introduced last summer in reaction to architects faking data for earthquake-proofing. The housing ministry was unable to get new software up and running in time, so new-building approvals collapsed. The jaw-dropping effect has been to knock 0.6 percentage points off growth, according to Takatoshi Ito of Tokyo University, who sits on the government's advisory Council on Economic and Fiscal Policy (CEFP).

Partly as a result, the government has lowered its forecast for growth in the fiscal year to the end of March, from 2.1% to 1.3%. Some economists think Japan is already tipping into recession. But the longer-term picture is more worrying. Mr Ito argues that if Japan pursued the kind of supply-side and tax reforms that the CEFP has long proposed, the country could grow at a respectable 2% a year. Without those reforms, growth will crawl along at 1-1.4%. Hopes of sensible policy have vanished since the opposition seized control of the upper house of the Diet (parliament) last July and Yasuo Fakuda's ruling coalition appears to lack the courage for reform.

Now, the Bank of Japan (BoJ) is adding to the uncertainty. At its policy-board meeting this week, the central bank was reluctant to admit that reality was at odds with its bullish view, though it acknowledged that momentum had slowed since its last outlook in October. Insisting, once again, that monetary policy should be “forward-looking”, its governor, Toshihiko Fukui, seemed to affirm that, far from cutting rates as other central banks are doing, the BoJ still hoped to raise them from unnaturally low levels.

Mr Fukui's term ends on March 19th, and somehow Japan's warring political parties must settle on a successor. With a slowing economy, the BoJ's conduct of monetary policy is about to become intensely politicised.

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Société Générale

Socked, not gently

Jan 24th 2008
From The Economist print edition

A French bank is hit by massive fraud

TROUBLE had been expected but nothing like this. Widespread concerns that Société Générale, a large French bank, had more subprime-related problems to reveal were proved right on January 24th with the announcement of a €2.05 billion ($3 billion) write-down on its exposure to mortgage-related investments and to creaking bond insurers. But those numbers were a side-show to something far more shocking.

The bank also disclosed that a single trader, Jérôme Kerviel, had racked up a further €4.9 billion loss by taking unauthorised bets on futures linked to European stockmarkets. Trading in SocGen's shares was temporarily suspended on January 24th, but punishment was bound to be severe.

The bank can at least claim to have acted quickly. The fraud was discovered on January 19th and the positions were quickly unwound, which may have contributed to this week's financial turmoil. The trader, who has fled, has been sacked and now faces legal action. His supervisors are also picking up pink slips. The bank also said it would fix its tattered balance sheet by raising €5.5 billion-worth of shares in a rights offer underwritten by JPMorgan and Morgan Stanley. Despite a precipitous fall in earnings—SocGen expects its 2007 profit to stand at just €600m-800m—the bank affirmed plans to pay a dividend.

Yet huge question marks remain over SocGen—including over whether it can survive alone. The bank, as it has to, says the fire has been contained. The fraud was “exceptional and isolated”; procedures have been tightened and revised. But those reassurances ring hollow. The sheer scale of the fraud is breathtaking. For comparison, Nick Leeson, the man who brought down Barings Bank in 1995, had lost a paltry £860m ($1.4 billion). It took Yasuo Hamanaka, a copper trader, ten years of hard work to lose Sumitomo $1.8 billion.

SocGen claimed that its rogue trader had been covering his tracks by creating a series of fictitious transactions, using dark arts learned during a spell in middle management. Even so, market-watchers expressed disbelief that such huge positions, in instruments that the bank itself described as “plain vanilla”, could have been built unnoticed. All this, to boot, at the bank heralded as equity-derivatives house of the year by the *Banker* magazine in 2007.

Suspicion will also infect other banks. Crédit Agricole, another French bank, owned up to an unauthorised €250m trading loss at its investment-banking arm in September. BNP Paribas was quick to say that the process of closing its books for 2007 had not turned up anything unusual. But the spectre of fraud will only add to fears about the quality of all banks' risk management.

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Economics focus

Faulty powers

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From The Economist print edition

Is monetary policy still a potent weapon against recession?

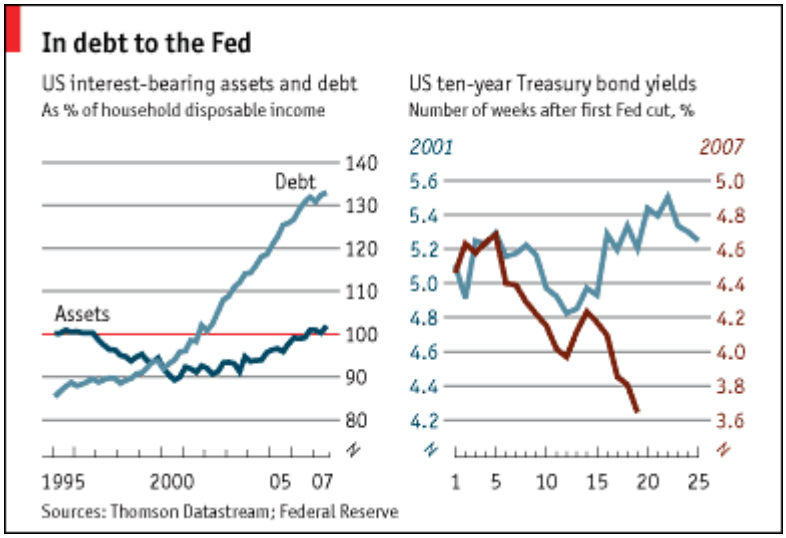
WRITING in *Slate* magazine in 1997, Paul Krugman, an American economist, neatly captured the widespread belief in the omnipotence of the then-chairman of the Federal Reserve. “If you want a simple model for predicting the unemployment rate in the United States over the next few years, here it is: it will be what [Alan] Greenspan wants it to be, plus or minus a random error reflecting the fact that he is not quite God.”

Faith in the Federal Reserve is not what it used to be. Since September the Fed has cut its policy rate by 1.75 percentage points, to 3.5%. It still has plenty of firepower left—rates are some way above the 1% level reached in 2003—but few seem willing to rely on monetary policy alone to save the day. Politicians and pundits alike were making a case for a fiscal stimulus package even before the Fed's surprise rate cut on January 22nd. That Ben Bernanke, the Fed chairman today, has given his blessing to the plan only adds to the impression that central banks have lost their grip.

What lies behind this loss of faith? One cause is the feeling that overly loose monetary policy got the economy into this mess. Repeated cuts in interest rates during the last downturn, in 2001-03, fuelled the housing and credit bubbles that are now bursting to such damaging effect. The legacies of that boom—falling asset prices, high consumer debt and bank losses—may now hamper the ability of central banks to prop up spending.

One of the ways that central banks affect the economy is through their influence on the price of assets, like shares or homes. Other things being equal, a reduction in short-term interest rates should bump up asset values, because their stream of future earnings is discounted by a smaller factor. Now that America's housing boom is ending, the worry is that the Fed is less able to stimulate the spending that comes with rising housing wealth. Assets are already dear, it is said; there are no bubbles left to reflate. Falling home prices make for a nation of savers, not shoppers. And firms are not keen to invest when the market value of their assets is shrinking.

Falling asset prices hurt the market for credit too, interfering with another policy channel. Monetary policy affects the choice between spending now or spending later and, for the cash-strapped, credit provides the bridge from the present to the future. Interest rates are the cost of using tomorrow's income to pay for today's spending. Lower rates lift spending by more when there is access to borrowing. Firms and homeowners can borrow cheaply with good collateral, but funds are less abundant when asset values are falling. Consumers may in any case have had their fill of borrowing. Household debt in America has vaulted to more than 130% of disposable income from less than 100% in 2000 (see left-hand chart). In Britain the ratio is higher still. And even if credit demand holds up, banks reeling from subprime-related losses are less willing to supply it.



Another strain of policy pessimism argues that interest-rate cuts will only fuel inflation, without helping the economy. In fact it seems likely that America's economic slowdown will create enough slack to ease inflationary pressure. That, at any rate, seems to be the judgment of the bond markets. In the months since the Fed's first rate cut in September, ten-year bond yields have dropped steadily, in contrast to the reaction to the rate cuts in early 2001, when bond yields drifted upwards (see right-hand chart).

The distant sound of whirring rotors

Central banks are not toothless, however. They can still affect spending by altering the returns of existing savers and borrowers. Lower interest rates increase the disposable income of debtors, by cutting their repayments, even as they eat into savers' cashflow. Borrowers are likely to spend more out of each additional dollar, so tilting the scales in their favour by cutting rates should boost demand. In America the household sector's debt has grown faster than its stock of interest-bearing assets, so the cashflow channel is now likely to be more, not less, powerful. The effect is probably stronger still in countries such as Britain and Spain, where most mortgage rates are closely tied to policy rates or fixed for only short periods.

Although the asset-price and credit channels are more constricted than in the past, monetary policy can still work through them. Interest-rate cuts are unlikely to lift house prices, but they may at least arrest the size and pace of price falls. The firms and households that are less burdened by debt will be able to take advantage of lower interest rates, even as others are struggling to reduce their borrowing.

If the Fed still has some clout, why the clamour for fiscal stimulus? In an election year, politics is one obvious factor, but economic arguments can also be brought to bear. One attraction is that it eases the over-reliance on monetary policy. Alan Blinder, a Princeton professor and former Fed governor, also argues* that fiscal remedies can boost demand more quickly than interest-rate cuts. Tax breaks work well if they bring spending forward, say by targeting help on the poor, who are more likely to spend than save—though this may be hard to arrange in practice. The drawback is that it leaves decisions to politicians, who risk taking too long to agree on the right policies in a slump and are unwilling to raise taxes in a boom.

Although monetary policy is normally best placed to help stabilise the economy, there are some circumstances where fiscal policy can help—during long or deep recessions, when demand suddenly slumps, or when interest rates fall to zero. In the latter case, writes Mr Blinder, “a combined monetary-fiscal effort—deficit spending or tax cuts financed by printing money—may be needed”. This is Milton Friedman's “helicopter drop” of money. Only then will the Fed really start to feel impotent.

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* The Case Against the Case Against Discretionary Fiscal Policy. Centre for Economic Policy Studies Working Paper No 100 (June 2004).

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Artificial life

Nearly there

Jan 24th 2008
From The Economist print edition

Getty Images

The penultimate step towards the creation of artificial life has just been announced

Get article background

LIKE a striptease artist in front of an eager audience, Craig Venter has been dropping veils over the past few years without ever quite revealing what people are hoping to see: the world's first artificial organism. He has been discussing making one since 1995, when he worked out the first complete genetic sequence of a natural living organism. And, after a lot of hard graft and blind alleys, he and his team have almost got there. As they report in this week's *Science*, they have replicated the genome of *Mycoplasma genitalium*, the species that was the subject of that original sequencing effort. It is not actual life, but it is surely the tease before the last veil finally falls away.

Though Dr Venter (pictured above at the helm of his yacht, *Sorcerer II*) is the public face of the effort, and the 17-strong team that did the work are all employed by the J. Craig Venter Institute in Rockville, Maryland, the synthetic genome project is equally the brainchild of his collaborator, Hamilton Smith. Indeed, it is in Dr Smith's name that the paper announcing the synthesis is published—along, of course, with the 16 others including Dr Venter himself.

It is a formidable effort. But what is, perhaps, most noteworthy is that the starting point for the project was not the raw nucleotides (the chemical letters of which DNA is composed), but a set of pre-assembled "cassettes" of DNA that the team had ordered from commercial suppliers. The point where any Tom, Dick or Harriet with a reasonably well equipped genetics laboratory could do likewise is not, therefore, that far off.

All you create

M. genitalium's genome is a single, circular chromosome that is 580,076 letters long, and contains 485 protein-coding genes. The team divided it on paper into 101 units (the cassettes), each containing four or five genes. They also took the precaution of editing one gene in particular, so that it would not work. The gene in question is crucial to *M. genitalium*'s ability to stick to mammalian cells, and thus become infective (it lives naturally in the urinary tract and is thought to cause urethritis). Disrupting it thus forestalled the risk of creating anything nasty.

The team placed orders for the cassettes with three firms that turn such things out routinely. They then used a variety of techniques, some old and some specially invented, to link the cassettes together into larger and larger units until they had two half chromosomes which, with the aid of some yeast cells, they turned into a whole one. All that remains to create what most researchers in the field would be willing to recognise as an artificial organism is to insert such a chromosome into a bacterial cell that has had its own chromosome removed. At the moment, no one is clever enough to make all of the cellular machinery that translates genes into the stuff of life. Hence the need for this shortcut. But if the newly reconstituted cell were able to grow and reproduce, the nature of its progeny would be dictated by the implanted chromosome. That, not the nature of the host “shell”, would define the species of the progeny.

Dr Venter's purpose in synthesising artificial genomes is twofold. Scientifically, he wants to understand how life works. One way to do this is to discover what he refers to as the minimal genome. This is a Platonic ideal of life, which would contain only the genes absolutely necessary for survival and reproduction, and might shed light on the nature of Luca, the last universal common ancestor of life on Earth. In practice, that ideal is difficult to realise, since many genes cover for each other. He knows that 100 of *M. genitalium*'s genes can be eliminated individually without killing it, but eliminate all of these and it dies. Assembling mix-and-match genomes with lots of different combinations of cassettes that each contain but a handful of genes should shed light on the question.

But Dr Venter is also a practical man, who wants to turn genomics into technology. Indeed, one of his other enterprises is a firm called Synthetic Genomics and he is one of the leading lights of the emerging field of synthetic biology. This seeks, among other things, to create a parts list of biological components such as DNA cassettes that could be ordered from catalogues in the way that electronic components can be.

Synthetic Genomics itself is a bit cagey about exactly which molecular products it is working on, but one of Dr Venter's interests is in using modified bacteria to make fuels. Natural bugs can turn out both hydrogen and methane. There is talk of modifying them to produce high-value liquid fuels, for jets, say.

He is not alone in this idea. Several Californian firms are also seeking to make advanced biofuels using modified bacteria. But if Dr Venter can take the final step of kicking the new, wholly synthetic genome into reproductive life, he will not only have made a great technological leap forward, he will also have erased one of the last mythic distinctions in science—that between living and non-living matter. Watching that veil drop will have been worth the wait.

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Microelectronics

Eyeing up a new technology

Jan 24th 2008
From The Economist print edition

A "bionic" eye lens points to a new way of building microelectronic circuits

CONVENTIONAL contact lenses are good at correcting vision. That, however, is not enough for Babak Parviz. Dr Parviz, who works at the University of Washington, in Seattle, wants to get them to provide information, too. His model is the "head-up" displays of useful information on the windscreens of aircraft. Putting such displays into lenses might be valuable for both soldiers and civilians, but shrinking the technology to the point where it could be done has proved hard. Last week, however, at a conference in Tucson, Arizona, organised by the Institute of Electrical and Electronics Engineers, Dr Parviz revealed that he was getting close.

The lenses are made of polyethylene terephthalate (PET), the stuff used in overhead projection sheets. Dr Parviz uses PET because his research has shown that metal circuits can be safely attached to it. The trick is building that circuitry in the first place, because the components—most notably, light-emitting diodes, or LEDs—have to be made at high temperatures using corrosive gases.

The usual way of doing this—on a piece of silicon that also serves as the circuit board—would not work on PET, which would be almost instantly destroyed. Instead, Dr Parviz uses a technique he developed the year before last, and for which this is the first application.

It works by etching small, precisely shaped holes in the PET. The shapes of the holes match the components. Those components are made elsewhere, using conventional, plastic-hostile techniques. They are then mixed together to create a grey powder that floats in alcohol over the surface of the lens.

When a component is over an appropriately shaped hole in the PET, it slips into position. In this way, not only can LEDs be laid down, but also tiny solar panels and antennae that convert radio waves into electrical energy. Everything is thus in place for a display unit that can both extract power from the outside world and also receive signals from it. All that need then be done is to encapsulate the result in Perspex—the material from which hard contact lenses are routinely made—to protect the circuitry without harming the wearer's eye. Lastly, the whole assembly is heated on an aluminium mould, so that it fits the eyeball of the wearer.

At the moment, Dr Parviz's prototype does not produce a useful image. That would require much more complicated circuitry than he has built so far. But he can make the LEDs flash on and off, so the principle seems to work.

The next stage is to get someone to try one of the lenses on. That, in today's risk-averse world, requires regulatory approval. But even by getting his self-assembled screen of LEDs to flash, Dr Parviz has shown that circuits can be built at room temperature this way. And that, rather than the details of this bionic-eye lens, is the real point of the exercise.

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Organ transplants

A successful mixture

Jan 24th 2008
From The Economist print edition

Transplanting immune-system stem cells along with kidneys stops rejection

WOE to the patient waiting for someone to offer up a spare organ for transplantation. Demand so far exceeds supply these days that in America alone around 17 people die every day while languishing in the queue. Nor do problems end there. Even the lucky ones, who do get their desired replacement part, face a lifetime on immunosuppressant drugs, to stop the alien tissue being rejected by their own immune systems.

David Sachs and Benedict Cosimi, of Harvard Medical School, have been working for some time to find a way around these problems. Their goal has been to trick the body into thinking that a foreign organ is really a native one, so that its immune system refrains from rejecting the foreigner. In this week's *New England Journal of Medicine* they report a small but promising study that, if confirmed on a grander scale, may deal with the issue once and for all and usher in a world in which immunosuppressant drugs are unnecessary and organs no longer need be matched to patients. That would make the lives of transplant patients easier and longer, and might also increase the useful supply of organs available for transplant.

Dr Sachs and Dr Cosimi tricked the body by transplanting a part of the donor's bone marrow along with the organ. Since the cells of the immune system are derived from stem cells in the bone marrow, these patients go on to develop what is known as chimeric immunity, which blends elements from the immune systems of both the donor and the recipient.

The process begins with the partial destruction of the recipient's own bone marrow using a drug called cyclophosphamide, followed by treatment with an antibody that depletes his supply of T cells, the part of the immune system that is most implicated in organ rejection. Once that is done, the organ (in this case a kidney) and the bone marrow are transplanted and the patient is confined for a fortnight in a sterile environment to protect him from infection while his new, mixed immune system boots up.

Dr Sachs and Dr Cosimi tried their new procedure on five people and it worked for four of them (though they did modify the process slightly after the third patient, by including antibodies against B cells, a second part of the immune system). On each occasion they transplanted a kidney that was, immunologically speaking, a poor match for the recipient. And in each of the four successful cases they were able take the patient off immunosuppressant drugs within 8-14 months, with no sign of rejection. All four of these patients are still alive; indeed, the first has now survived for more than five years. (The one failure later received a standard transplant, followed by a permanent regimen of immunosuppressant drugs, and is also still alive.)

Although the technique looks promising, it is a mystery why it should work. You would think that a chimeric immune system would be more active, not less, and would therefore attack the recipient's other organs, since they look foreign to the transplanted immune cells. Not so. Nor is it clear how the transplanted immune cells stop the existing ones from attacking the new organ. And, the immune system does not stay chimeric forever. Eventually, the original one predominates and the transplanted one vanishes (or, at least, becomes undetectable). Yet the transplant's protective effect persists with no sign, as yet, of diminishing—and there is every reason to believe, based on the results of experiments on monkeys, that it will not diminish in the future.

Four successes are not, of course, proof of a reliable technique. And even if the approach works for kidneys, it has yet to be tested for other organs. Neither does eliminating rejection increase the supply of organs for transplant, even though it means that fewer will be wasted. But Dr Sachs and Dr Cosimi have a suggestion here, too. They hope their discovery may allow organs to be transplanted from other species, such as pigs, and have filed a patent based on the idea.

Xenotransplantation, as this idea is known, really would increase the supply of organs, but it is a controversial idea. The “yuck” factor that cross-species transplants would probably provoke would surely fade if lives were saved. However, xenotransplantation brings the risk of transplanting animal viruses and thus creating new human diseases. It would be an irony if something intended to preserve lives ended up destroying them.

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Physiognomy and success

Face value

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From The Economist print edition

What the boss looks like determines how he performs

A COUPLE of years ago a group of management scholars from Yale and the University of Pittsburgh tried to discover if there was a link between a company's success and the personality of its boss. To work out what that personality was, they asked senior managers to score their bosses for such traits as an ability to communicate an exciting vision of the future or to stand as a good model for others to follow. When the data were analysed, the researchers found no evidence of a connection between how well a firm was doing and what its boss was like. As far as they could tell, a company could not be judged by its chief executive any better than a book could be judged by its cover.

A few years before this, however, a team of psychologists from Tufts University, led by Nalini Ambady, discovered that when people watched two-second-long film-clips of professors lecturing, they were pretty good at determining how able a teacher each professor actually was. At the end of the study, the perceptions generated by those who had watched only the clips were found to match those of students taught by those self-same professors for a full semester.

Now, Dr Ambady and her colleague, Nicholas Rule, have taken things a step further. They have shown that even a still photograph can convey a lot of information about competence—and that it can do so in a way which suggests the assessments of all those senior managers were poppycock.

Dr Ambady and Mr Rule showed 100 undergraduates the faces of the chief executives of the top 25 and the bottom 25 companies in the *Fortune* 1,000 list. Half the students were asked how good they thought the person they were looking at would be at leading a company and half were asked to rate five personality traits on the basis of the photograph. These traits were competence, dominance, likeability, facial maturity (in other words, did the individual have an adult-looking face or a baby-face) and trustworthiness.

By a useful (though hardly unexpected) coincidence, all the businessmen were male and all were white, so there were no confounding variables of race or sex. The study even controlled for age, the emotional expression in the photos and the physical attractiveness of the individuals by obtaining separate ratings of these from other students and using statistical techniques to remove their effects.

This may sound like voodoo. Psychologists spent much of the 20th century denigrating the work of 19th-century physiognomists and phrenologists who thought the shapes of faces and skulls carry information about personality. However, recent work has shown that such traits can, indeed, be assessed from photographs of faces with a reasonable accuracy.

And Dr Ambady and Mr Rule were surprised by just how accurate the students' observations were. The results of their study, which are about to be published in *Psychological Science*, show that both the students' assessments of the leadership potential of the bosses and their ratings for the traits of competence, dominance and facial maturity were significantly related to a company's profits. Moreover, the researchers discovered that these two connections were independent of each other. When they controlled for the “power” traits, they still found the link between perceived leadership and profit, and when they controlled for leadership they still found the link between profit and power.

These findings suggest that instant judgments by the ignorant (nobody even recognised Warren Buffett) are more accurate than assessments made by well-informed professionals. It looks as if knowing a chief executive disrupts the ability to judge his performance.

Sadly, the characteristics of likeability and trustworthiness appear to have no link to company profits, suggesting that when it comes to business success, being warm and fuzzy does not matter much (though these traits are not harmful). But this result also suggests yet another thing that stockmarket analysts

might care to take into account when preparing their reports: the physog of the chief executive.

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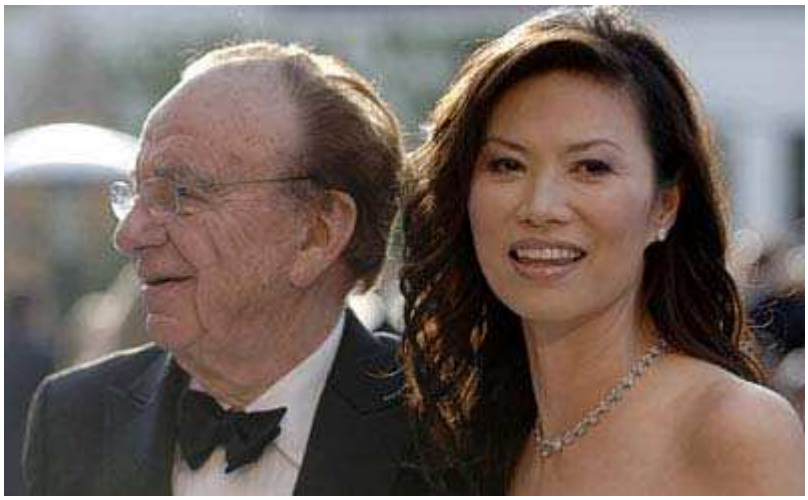
Rupert Murdoch

Spend some, then spend some more

Jan 24th 2008
From The Economist print edition

Reuters



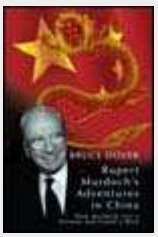
News Corporation's ambitions have been thwarted in China by fearful officials and canny businessmen. But Rupert Murdoch has not quite given up

FAR earlier than many, Rupert Murdoch sensed that China might be a unique financial prize. Even on his first visit in the mid-1980s, with his then wife, Anna, and their school-age children, the Australian news magnate dined with the leadership.

For much of the next 20 years, Mr Murdoch tried to conquer China. His initial aim was to create a satellite television network that would absorb a share of the advertising, now estimated at about $50 billion a year, that was sold on state-owned news media. The Chinese encouraged him and then pulled back. Ultimately they outmanoeuvred him, beating him at his own game. Mr Murdoch hoped that the more he invested, the sooner satellite dishes would be sprouting from every Chinese rooftop. But satellite dishes are still regulated, even if not as strictly as they once were.

Bruce Dover, an Australian, was Mr Murdoch's man in Beijing until 1998. He has written a rare insider's account of how the Chinese got the better of a businessman who usually gets what he wants. Mr Murdoch felt that if only he could meet President Jiang Zemin all would be fine, Mr Dover writes. Eventually, Mr Murdoch did get to spend time with the president; quite a bit of it, in fact. They got on well. Mr Murdoch treated the Chinese leader, a film fan, to an exclusive screening of “Titanic”, which had been made by Mr Murdoch's 20th Century Fox.

Rupert's Adventures in China: How Murdoch Lost a Fortune and Found a Wife
By Bruce Dover



Mainstream Publishing; 304 pages; £18.99

Buy it at
Amazon.co.uk

The Chinese let him invest lavishly in internet and programming companies, thus giving them precious technical know-how. They particularly admired Mr Murdoch's management structure because it was like theirs: a Sun King at the centre with acolytes all around. The Chinese were excellent businessmen, but they wanted China's profits for China. Even with investments in groundbreaking television production in China, Mr Murdoch could not win for himself the concessions that usually came with publishing favourable editorials for presidents and prime ministers in the West. The Murdoch charm had beguiled the highest levels of government in Australia, America and Britain. In China, it failed.

Mr Murdoch did make some gains. In 2002 his Star TV was given permission to sell programming for cable systems in Guangdong province. But when the company tried to expand its distribution by the back

door, using the remote Qinghai province as a base and exploiting a regulatory loophole to circumvent a ban on domestic cable-television owners carrying foreign broadcasters, the government reacted swiftly. The Chinese propaganda department forced Star TV to close down the operation. The Qinghai fiasco, News Corporation staff estimate, cost Star TV $30m-60m. Then in 2003 Mr Jiang was replaced by the less amenable Hu Jintao. Two years later a frustrated Mr Murdoch announced he had hit a “brick wall” in China.

While courting the Chinese leadership, Mr Murdoch met Wendi Deng, a talented executive with an MBA from Yale University. Ms Deng was born in mainland China and worked in the business development department at Star TV in Hong Kong. Mr Dover introduced them at a company cocktail party. They married in 1999 and Ms Deng became Mr Murdoch's new connection to China, though she possessed little understanding of the opaque politics of her birthplace. Ms Deng is now in charge of MySpace.com in China. Like all dotcom operations there, it is a ward of the Chinese censors. But it remains one of the most promising of News Corporation's now limited Chinese operations.

Mr Murdoch has cooled on China. In recent months he has found a new passion, retooling the *Wall Street Journal*.

Few News Corporation executives have written about their boss. Mr Dover does so evenly, without venom, and with a quizzical tone that suggests Mr Murdoch was a little naive about the Chinese. He tells the reader about Mr Murdoch's perpetual motion, his mania for phoning his executives at all hours, and how he keeps tabs on his $70 billion business by always travelling with a blue folder containing weekly print-outs of the financial status of his companies from New York to Cairns.

No one has staked so much personal prestige on the quest for China, Mr Dover says. Foreign companies have yet to be allowed into the 380m Chinese homes that have televisions. Now nearly 77, Mr Murdoch is beginning to recognise that this may not happen on his watch.

Rupert's Adventures in China: How Murdoch Lost a Fortune and Found a Wife.
By Bruce Dover.
Mainstream Publishing; 304 pages; £18.99

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Doing business in China

By the book

Jan 24th 2008
From The Economist print edition

Choose wisely from the torrent of books on doing business in China

BUSINESS books on China are published so frequently these days, it seems there is a secret factory churning them out. Too many read like the mass produced goods for which the country is famous—and too few are written from real experience of living in China.

Managing the Dragon (Crown; $27.50), Jack Perkowski's story of his almost 13 years running Asimco, an automotive components maker, in China is therefore a rare treat—a first-hand account of the struggle to build a business there. Tim Clissold, Mr Perkowski's former colleague, has already described how Asimco's Chinese partners cheated it out of millions, in his riveting 2004 book, “Mr China”. But Mr Perkowski hung on, and his wise and ultimately optimistic account should be required reading for anyone starting a business in China. Mr Perkowski is sensible on every issue—from the need to nurture (and listen to) local managers to the relative importance of local over central government relations. Most of all, foreigners must not shun the impossibly cut-throat local market because the price paid for a product in China today will be its price globally tomorrow.

This is what **The China Price** (Penguin Press; $25.95) is all about. As a former *Financial Times* journalist covering the Pearl River Delta, Alexandra Harney visited scores of factories in the workshop of the world, talking to owners, workers and Western buyers. Her account, packed with local colour, helps readers smell the sweat on the shop floor. But Ms Harney's bleak conclusion that cheap Western goods are bought at the cost of worker exploitation in China is predictable and naive, flying in the face of the migration of millions from rural misery to the comparative riches offered in a Guangdong factory.

There is a gloomy message too in **Beware the Dragon** (André Deutsch; $37.25 and £18.99). Erik Durschmied, a veteran war correspondent, gallops through 1,000 years of Chinese history and sees only misery and bloodshed, from Genghis Khan to the Korean war. Apparently, the mainland was even responsible for the bubonic plague in 14th-century Europe, which spread west from unburied corpses after an earthquake in southern China. Mr Durschmied concludes that China will cause more upheaval in future, though he cannot decide whether it will attack a rival, such as Japan, start a trade war that becomes a real war, or simply implode and drag others into its civil infighting.

A more reassuring perspective on whether China can rise peacefully to superpower status is provided by David Kang, a professor at Dartmouth College, New Hampshire. He argues convincingly, if dryly, in **China Rising** (Columbia University Press; $24.95 and £14.95) that while the ascent of a great power should be destabilising, China's economic rise since 1978 has anchored East Asia's prosperity—and that most other countries in the region prefer a strong China to a weak one. Even Japan and America, he predicts, will accept this reality in time.

Of less value to students of China are two books that purport to provide the most value of all. Both **A Bull in China** (Random House; $26.95, John Wiley; £14.99) by Jim Rogers, who shot to fame as the “investment biker” and **From Wall Street to the Great Wall** (Norton; $26.95 and £16.99) by Burton Malkiel and Patricia Taylor, claim they will help readers to profit from China's boom. But their tutorials on the merits of various mainland assets are cursory and Mr Rogers's virtual tipping of individual shares for an American audience seems downright irresponsible. If proof were needed that there is a bubble in Chinese stocks, this is it—and that goes for books on China too.

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Chinese and Indian capitalism

Shifting the balance

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From The Economist print edition

FIVE years ago, Tarun Khanna, an Indian-born professor at Harvard Business School, grabbed attention with an article in *Foreign Policy* magazine speculating that India might eventually overtake China. Co-written with Yasheng Huang, a Chinese-American scholar at the Massachusetts Institute of Technology, the article argued that India's economic model offers more freedom to entrepreneurs which could help the country outpace its fellow Asian giant in the longer term.

From a macroeconomic viewpoint, this argument was rather implausible, except in the extremely long term, for China's economy is already three times the size of India's. At the corporate level, though, it made more sense: as its recent unveiling of the world's cheapest car showed, companies such as Tata Motors promise to make the global grade rather faster than their Chinese counterparts.

With his new book Mr Khanna has returned to the topic of entrepreneurship in Asia's emerging giants. But he has dropped the idea of India outpacing China and replaced it with thoughts about the potential for co-operation between the two countries. Their social and economic systems are vastly different, as he shows in admirably detailed but chatty studies of companies and cities in both places. But they have strengths that could be complementary, he thinks, and he argues that foreign multinationals need to start thinking about the countries together rather than separately.

Billions of Entrepreneurs: How China and India are Reshaping Their Futures and Yours
By Tarun Khanna

Harvard Business School Press; 352 pages; $29.95

Buy it at
Amazon.com
Amazon.co.uk

Unfortunately, the book's enthusiasm for Sino-Indian co-operation is rather unconvincing. Trade between the two countries is rising fast, as Mr Khanna points out, but from a very low base: it is only a tenth as large as trade between China and Japan, and a fifth as large as that between China and South Korea. Chinese companies want to learn about Indian software and outsourcing, just as Indian companies want to learn about Chinese manufacturing prowess. But then companies in both countries are also eagerly studying practices and skills in Europe, America and Japan too: there is nothing particularly special about the flow of people and ideas between India and China.

Politics, too, plays a part. Mr Khanna makes much of the opening of a border crossing high in the Himalayas to trade in 2006, for the first time since the Sino-Indian border war of 1962. Yet that crossing does not connect any of the large areas that are still disputed between the two countries, and only a few categories of goods may be traded through the reopened area. Relations between China and India have indeed been getting warmer in recent years, but the pair still harbour strong and understandable suspicions about one another: they are natural rivals, whether in Asia as a whole or in the countries squeezed between them, as the book's excellent section on Myanmar demonstrates.

Nevertheless, although the book's overall thesis feels as implausible as that of Mr Khanna's 2003 *Foreign Policy* article, “Billions of Entrepreneurs” remains well worth reading. The eye of this business-school professor for interesting stories is sharp and he offers illuminating explanations of why India and China work in the ways that they do.

Billions of Entrepreneurs: How China and India are Reshaping Their Futures and Yours.
By Tarun Khanna.
Harvard Business School Press; 352 pages; $29.95

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New film: “Katyn”

Unburied dead

Jan 24th 2008
From The Economist print edition

Poland's historical epic in the limelight

A CRIME and a lie are the twin strands in the shameful tragedy of Katyn: the massacre of 20,000 Polish officers by the Soviet secret police, and the cover-up that followed. Now Andrzej Wajda, Poland's leading film maker, has made his last film (he is 81) about what he calls the “unhealed wound” in his country's history.

Mr Wajda's own father, Jakub, was murdered at Katyn, as were family members of many of the production team. Those killings come in a gruelling, 15-minute final sequence. First, the film shows in sombre and claustrophobic detail the Polish POWs' travels to Golgotha; the occupation authorities' vengeance on their families, and flashes forward to the attempts by the country's post-war rulers to disguise and deface the historical record.

The film has been nominated for best foreign-language film at this year's Oscars. Those watching it should not expect to come away happily humming the dramatic theme music by Krzysztof Penderecki. “Katyn” is based on the letters and diaries of real-life victims—unearthed when the Nazis first came across the mass graves in 1943. The last entry records the Polish officers' arrival at the killing fields. “A thorough search. They didn't find my wedding ring. They took my belt, my penknife and my watch. It showed 0630 Polish time. What will happen to us?”

Expert cinematography, compelling acting, and a story that leaves the viewer both sorrowful and angry, are a strong combination. But they may not be quite enough to convince the judges. “Katyn” is filmed from an uncompromisingly Polish point of view. Some outsiders may find it confusing. One of the most powerful scenes, for example, is the mass arrest of the professors of Cracow University by the Germans. Those who already know about the upheaval that followed the German invasion of 1939 will see the point: the Soviets and the Nazis were accomplices. Others may puzzle.

The moral dilemmas of post-war Polish collaborators are better portrayed than those of the wartime occupiers. If honouring the dead means doom for your family—or for you—is it better to keep silent? Poles faced that choice again and again after 1945, as their new rulers used Katyn as a litmus test of loyalty. But barring one Red Army officer, impeccably played by a Ukrainian actor, Sergei Garmash, who saves his neighbours (an officer's widow and child) from deportation, the foreigners are so villainous as to be little more than sinister mannequins.

Melodrama is perhaps one fault of the film; an oddly sanitised picture of daily life is another. Teeth, complexions and clothes all evoke the prosperous Poland of today more than the squalor and hunger of 1945. Material deprivation brings out the worst and the best in people. But it needs to be shown to make the measure convincing.

Astonishingly, some in Russia are now reviving the lie that the murderers at Katyn were not by the NKVD, but the Nazis. That was maintained during the communist era, but only by punishing savagely those who tried to tell the truth. Last year, as Mr Wajda's film opened in Poland, a commentary in a Russian government newspaper, *Rossiiskaya Gazeta*, dismissed the evidence of Soviet involvement in Katyn as “unreliable”. An Oscar would be a good answer to that.

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New fiction

The winds of war

Jan 24th 2008
From The Economist print edition

WERE it not for the author's photo on the jacket, few would guess that this war story was written by a woman. The details of RAF bombing missions over Germany are scrupulous. More impressive still, A.L. Kennedy has a keen feel for the jousting indirection of male banter. She skilfully depicts the discontinuity between the bursting emotions of men's interior life and the choked, inarticulate bleating that expresses them—or fails to. “Day” was published in Britain last year and well deserved to win the 2007 Costa book of the year award, announced this week. The novel has just come out in America.

Day
By A.L. Kennedy

Knopf; 288 pages; $24.
Jonathan Cape; £16.99

Buy it at
Amazon.com
Amazon.co.uk

Young and working class, Alfie Day is attached to his mother and fears he will no longer be able to protect her from his violent father when he enlists. Nevertheless, with suicidal bravado, he volunteers as a tail gunner. The countdown to flying the 30 missions that will complete his service to the crown recollects the same countdown in Joseph Heller's “Catch-22”: a race between luck and doom. Likewise, in portraying the airmen's distinctively intimate bond, “Day” is in some ways “Catch-22” with the humour removed. But then, both authors would concur that their central material isn't funny.

While on leave Alfie falls in love with a young woman in London. She is already married to a serviceman away at war. And it is a discipline not to permit himself the fantasy that he will survive to claim his small patch of ordinary happiness (perhaps too that the husband will not), when fantasising about surviving to next week seems an indulgence. Sure enough, on mission number 26 Alfie's bomber is downed. His comrades perish, and Alfie becomes a German prisoner of war.

Providing the novel with its sophisticated texture, the story alternates between war and the parody of war—in this case the set of a mocked-up POW camp, where Alfie is performing as an extra in a film five years after the armistice. Keeping track of these time shifts takes concentration, since the author will sometimes deliberately blur the line between war as grand drama and war as farce.

Ms Kennedy manages to make every battle truism fresh—in particular, the cliché about how “you never feel so alive”. Yet in rendering the guilt, numbness and bewilderment of its aftermath, she also kills off any foolish temptation to envy the intensity of warfare.

Day.
By A.L. Kennedy.
Knopf; 288 pages; $24.
Jonathan Cape; £16.99

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Parmigianino at the Frick

One and only

Jan 24th 2008 | NEW YORK
From The Economist print edition

The Frick Collection's new exhibition consists of a single painting

THE Frick Collection may own some world-famous paintings, including three Vermeers, but it lacks the space to put on blockbuster shows. So staging an exhibition consisting of just one picture has its attractions.

“Antea”, by Francesco Mazzola Parmigianino (1503-1540), is a luxuriously dressed, radiant young beauty who looks straight at the viewer with a magnetically arresting gaze. Colin Bailey, the Frick's chief curator, was especially keen on borrowing this nearly full-length portrait from the Capodimonte museum in Naples, because he believed it would energise the Frick's permanent collection and give the museum a chance to produce important, original scholarship.

Mr Bailey was right on both counts. Hanging on a temporary, free-standing wall in the middle of the Frick's Oval Room, a glowing “Antea” beckons to visitors from across the museum's sepulchral Garden Court. Quite who the sitter was remains a mystery. The catalogue, by Christina Neilson, a Renaissance specialist and Frick fellow, reads like a detective story; though not so much a “whodunit” as a “who is it”.

Parmigianino had been dead for more than a century before Giacomo Barri, a Venetian-born painter and print maker, dubbed the portrait “Antea” in his 1671 oeuvre, “Viaggio pittoresco d'Italia” (“A painter's voyage through Italy”). Barri's assertion that the sitter was Parmigianino's mistress unleashed speculation that has not stopped since. It has been claimed in turn that she was a famous Roman courtesan, a garden-variety prostitute, an aristocrat, a servant, a noble bride, the painter's sister or, most recently, a man.

Ms Neilson tests each claim against clues provided by Antea's costume and jewellery, and details from contemporary poetry, as well as other works of art. In the process she re-dates the painting to between 1531 and 1534 (earlier scholars had placed it between 1535 and 1537). In support of this, Ms Neilson cites the strong resemblance between the face of “Antea” and that of one of the lovely angels in another Parmigianino work of 1534, “Madonna of the Long Neck”. Then there is the similarity between the left hand in “Antea” and those in two red chalk studies done in the early 1530s. Her puffed sleeves and plunging neckline are also similar to the gown in Bartolomeo Veneto's “Portrait of a Lady in a Green Dress” of 1530.

The importance of yellow

But it is her luxurious apparel that has the biggest role in the discussion of Antea's identity. The gown she wears is yellow, the colour prostitutes in many Italian cities were forced to wear to distinguish them from other women. But, as Ms Neilson points out, in 16th-century Italy—when courtesans and aristocrats often dressed alike—noblewomen had also taken to favouring yellow.

The lavish ruby and pearl jewel in Antea's hair, has been cited as proof that the sitter was a noble young bride. Ms Neilson agrees that such pendants were symbols of love and marriage, adding that Parmigianino even drew designs for them. Antea's gold chain and the lush marten fur draped over one of her shoulders (an emblem of fertility) were equally symbolic, although Ms Neilson is careful to note that courtesans favoured such accessories too.

The publication six years ago of a previously unrecorded Parmigianino drawing, “Head of a Young Man Looking Up”, which sold at Christie's in New York for more than five times its top estimate, led to claims that “Antea” was a man. Parmigianino was known to alter the gender of figures between his preparatory sketches and finished paintings, But Ms Neilson comes to a different conclusion. She believes the resemblance between the two figures illustrates the painter's fantasy of what constitutes ideal beauty.

Little known abroad, Parmigianino is revered in Italy. In his lifetime he was hailed as the new Raphael. Giorgio Vasari, in his 16th-century “Lives of the Artists”, records that when German soldiers broke into Parmigianino's studio during the sack of Rome in 1527, they were so captivated by his work they left him alone to produce more. When Ferdinand IV, King of Naples, fled advancing French troops in 1798 he took with him to Palermo some 20 works from the remarkable Farnese collection, his grandmother Elisabetta having been the last of the Farnese line. “Antea” was among them.

Twenty years later the pictures were back in Naples and today they form the core of the Capodimonte's holdings. In 1945, a cache of pictures that had been removed from the museum for safekeeping before being discovered by the Nazis, was found hidden in Salzburg. It included the Farnese Titians—and “Antea”.

The Frick exhibition, which builds on its 2004 show of Parmigianino drawings that attracted much critical and public interest, may lead to a reconsideration of his stature in America. According to Ms Neilson, Parmigianino “created a woman with whom the viewer could fall in love”. She is such a draw at the Capodimonte that the museum often runs out of postcard reproductions of the picture. People have been falling in love with “Antea” for centuries. Some 22 years after “Antea” was last there, it is again New York's turn.

“Parmigianino's 'Antea': A Beautiful Artifice” is at the Frick Collection from January 29th until April 27th

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Bobby Fischer

Jan 24th 2008
From The Economist print edition

Camera Press

Bobby Fischer, an unsettling chess-player, died on January 17th, aged 64

PEOPLE were always coming to get Bobby Fischer. And he was ready for them. In a locked suitcase he kept bottles and bottles of vitamin pills and herbal potions and a large orange-juicer, in case they tried to put toxins in his food. His most precious memorabilia—match notebooks, photo albums, letters from President Nixon—were kept in a filing cabinet in a safe behind two combination locks in a ten-by-ten storage room in Pasadena, California. In the end, as he railed to radio talk-show hosts in Hungary and the Philippines, even all this couldn't keep him safe from Russians, or Jews, or “CIA rats who work for the Jews”. But he had tried.

They tried to disrupt his chess games, too. As he wrestled for the world championship against Boris Spassky at Reykjavik in 1972 they poked whirring TV cameras over his shoulder. They made the board too shiny, reflecting the lights, and fidgeted and coughed until he cleared out the first seven rows of the audience. By the third game he insisted on retreating to a tiny back room, where he could think. He was always better in dingy, womb-like spaces: the cabinet room of the Marshall Chess Club in New York City, where as a boy he skipped school to spend his mornings reading through old file-cards of 19th-century games; a particular table in the New York Public Library, where he sat for hours immersed in chess history, openings and strategy; or the walk-up family flat in Brooklyn where, once his mother and sister had moved out, he set up continuous chess games beside each bed, ignoring the outside sunshine to compete against himself. If you could see inside his brain, as his enemies no doubt hoped to, you would find it primed to attack and defend in every way possible, with a straight-moving rook or a sidling bishop, or with both in his favourite Ruy Lopez opening, or with the queen swallowing an early pawn in the “poisoned” version of the Sicilian, or a thousand others. At Reykjavik, when Mr Spassky was advised between games by 35 Russian grand masters, Mr Fischer had a notebook and his own long, lugubrious, clever head. And he won.

That made him a cold-war hero. The quirky individual had outplayed the state machine, and America had thrashed the Soviet Union at its own favourite game. But Mr Fischer, for all his elegant suits and childhood genius, his grandmastership at 15 and his 20-game winning streak at championship level in 1968-71, was always an unsettling poster-boy. His objective, he told everyone, was not just to win. It was to crush the other man's mind until he squirmed. And, in proper capitalist style, to get rich. At his insistence, the championship money was raised from $1,400 to $250,000; from the rematch with Mr Spassky in 1992, which he also won, he took away $3.5m. Since few venues, even Qatar or Caesar's Palace, offered him enough to make public playing worth his while, he spent the years after 1975 (when he forfeited his world title by refusing to defend it) largely wandering the world like a tramp, castigating his enemies. Only cold, eccentric Iceland welcomed him.

A house like a rook

What exactly was wrong with Bobby Fischer was a subject of much debate. The combination of high intelligence and social dysfunction suggested autism; but he had been a normal boy in many respects, enjoying Superman comics and going to hockey games. He had got mixed up in the 1960s with the Worldwide Church of God, a crazed millenarian outfit, and perhaps had learned from them to hate and revile the Jews; though he was Jewish himself, with a Jewish mother who had tried psychologists and the columns of the local paper to cure him of too much chess, but who still couldn't stop the pocket set coming out at the dinner table.

Possibly—some said—he had been unhinged by the American government's stern pursuit of him after the 1992 rematch, which was played illegally in the former Yugoslavia. He cursed “stinking” America to his death, and welcomed the 2001 terrorist attacks as “wonderful news”—at which much of the good he had done for chess in his country, from inspiring clubs to instructing players to simply making the game, for the first time, cool, drained away like water into sand.

Perhaps, in the end, the trouble was this: that chess, as he once said, was life, and there was nothing more. Mr Fischer was not good at anything else, had not persevered in school, had never done another job, had never married, but had pinned every urgent minute of his existence to 32 pieces and 64 black and white squares. He dreamed of a house in Beverly Hills that would be built in the shape of a rook.

Within this landscape, to be sure, he was one of the world's most creative players; no one was more scathing about the dullness of chess games that were simply feats of memorising tactics. Most world-championship games, he claimed, were pre-arranged, proof that the “old chess” was dead, and rotten to the core. He invented a new version, Fischer Random, in which the back pieces were lined up any old how, throwing all that careful book-learning to the winds. Yet the grid remained and the rules remained: attack, defend, capture, sacrifice. Win at all costs. From this grid, and from this war, Mr Fischer could never escape.

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Overview

Jan 24th 2008
From The Economist print edition

After several turbulent days in global **stockmarkets**, the Dow Jones Industrial Average rebounded on January 23rd, closing up 2.5% after having at one point been 2.7% down during the day. The recovery came after a meeting between the New York State insurance regulator and several banks, to discuss support for troubled bond insurers.

The **Federal Reserve** surprised financial markets by slashing its benchmark interest rate by three-quarters of a percentage point, to 3.5%, at an emergency meeting on January 22nd. A further reduction is expected when the Fed's rate-setters convene again for a scheduled two-day meeting on January 29th and 30th.

To maintain its peg with the dollar, the **Hong Kong Monetary Authority** followed the Fed's move by cutting its key rate by 75 basis points, to 5%. The Bank of **Canada** lowered its benchmark rate from 4.25% to 4%.

Britain's GDP rose by 0.6% in the fourth quarter, according to a preliminary estimate. Only one member of the Bank of England's nine-strong monetary-policy committee voted for a rate cut, according to the minutes of its meeting earlier this month.

Consumer prices in **Australia** rose by 0.9% in the fourth quarter, leaving them 3.0% higher than a year earlier. On the central bank's preferred measure, which filters out the biggest price gains and falls, prices rose by 3.8% from a year earlier—well above the target band of 2-3%.

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Output, prices and jobs

Jan 24th 2008
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2008†	2009†	latest	latest	year ago	2008†	rate‡, %
United States	+2.8 Q3	+4.9	+1.8	+2.6	+1.5 Dec	+4.1 Dec	+2.5	+2.8	5.0 Dec
Japan	+1.9 Q3	+1.5	+1.4	+1.9	+2.9 Nov	+0.6 Nov	+0.3	+0.3	3.8 Nov
China	+11.2 Q4	na	+10.1	+9.6	+17.4 Dec	+6.5 Dec	+2.8	+3.5	9.5 2007
Britain	+2.9 Q4	+2.4	+1.9	+2.2	+0.4 Nov	+2.1 Dec§	+3.0	+2.1	5.3 Nov††
Canada	+2.9 Q3	+2.9	+1.9	+2.5	+0.8 Oct	+2.5 Nov	+1.4	+1.9	5.9 Dec
Euro area	+2.7 Q3	+2.8	+1.8	+2.0	+2.7 Nov	+3.1 Dec	+1.9	+2.3	7.2 Nov
Austria	+3.3 Q3	+3.0	+2.6	+2.6	+1.1 Nov	+3.6 Dec	+1.5	+2.1	4.3 Nov
Belgium	+2.6 Q3	+2.2	+2.0	+2.0	+0.6 Oct	+3.1 Dec	+1.6	+2.0	10.7 Nov‡‡
France	+2.2 Q3	+3.2	+1.8	+2.0	+2.5 Nov	+2.6 Dec	+1.5	+2.0	7.9 Q3§§
Germany	+2.5 Q3	+2.8	+1.9	+2.1	+3.5 Nov	+2.8 Dec	+1.4	+2.1	8.4 Dec
Greece	+3.8 Q3	+3.6	+2.9	+2.5	+3.6 Nov	+3.9 Dec	+2.9	+3.0	7.9 Oct
Italy	+1.9 Q3	+1.7	+1.3	+1.5	−2.4 Nov	+2.6 Dec	+1.9	+2.3	5.9 Q3
Netherlands	+4.2 Q3	+7.5	+2.1	+2.2	+1.8 Nov	+1.9 Dec	+1.3	+2.0	4.1 Dec††
Spain	+3.8 Q3	+2.9	+2.4	+2.3	−0.6 Nov	+4.2 Dec	+2.7	+3.1	8.2 Nov
Czech Republic	+6.0 Q3	+5.8	+4.8	+5.3	+6.7 Nov	+5.4 Dec	+1.7	+5.4	6.0 Dec
Denmark	+1.7 Q3	+6.7	+1.6	+1.7	−1.9 Nov	+2.3 Dec	+1.8	+2.0	2.7 Dec
Hungary	+1.0 Q3	+1.2	+3.0	+3.7	+5.5 Nov	+7.4 Dec	+6.5	+4.5	7.5 Nov††
Norway	+3.1 Q3	+5.6	+2.9	+2.6	+2.0 Nov	+2.8 Dec	+2.2	+2.4	2.5 Oct
Poland	+6.4 Q3	na	+5.2	+4.4	+6.2 Dec	+4.0 Dec	+1.4	+3.6	11.2 Nov‡‡
Russia	+7.6 Q3	na	+6.7	+5.7	+6.5 Dec	+11.9 Dec	+9.0	+11.5	5.9 Nov‡‡
Sweden	+2.5 Q3	+2.4	+2.7	+2.6	+4.2 Nov	+3.5 Dec	+1.6	+2.6	5.6 Dec‡‡
Switzerland	+2.9 Q3	+1.3	+2.0	+2.0	+10.7 Q3	+2.0 Dec	+0.6	+1.4	2.6 Dec
Turkey	+1.5 Q3	na	+3.8	+5.2	+7.7 Nov	+8.4 Dec	+9.7	+8.1	9.2 Q3‡‡
Australia	+4.3 Q3	+4.1	+3.6	+3.4	+1.6 Q3	+3.0 Q4	+3.3	+3.2	4.3 Dec
Hong Kong	+6.2 Q3	+7.0	+4.8	+5.7	−2.1 Q3	+3.8 Dec	+2.3	+3.6	3.4 Dec††
India	+8.9 Q3	na	+7.7	+7.2	+5.3 Nov	+5.5 Nov	+6.3	+6.1	7.2 2007
Indonesia	+6.5 Q3	na	+6.1	+5.7	+8.3 Oct	+6.6 Dec	+6.6	+6.4	9.8 Feb
Malaysia	+6.7 Q3	na	+5.7	+5.9	+2.7 Nov	+2.4 Dec	+3.1	+2.8	3.1 Q3
Pakistan	+7.0 2007**	na	+5.4	+5.4	+9.8 Oct	+8.8 Dec	+8.9	+7.9	6.2 2006
Singapore	+6.0 Q4	−3.2	+4.9	+4.7	−1.5 Nov	+4.4 Dec	+0.8	+3.0	1.7 Q3
South Korea	+5.2 Q3	+5.4	+4.6	+4.6	+10.8 Nov	+3.6 Dec	+2.1	+2.9	3.1 Dec
Taiwan	+6.9 Q3	na	+4.6	+3.9	+10.7 Dec	+3.3 Dec	+0.7	+2.0	3.9 Nov
Thailand	+4.9 Q3	+6.3	+4.8	+4.1	+10.8 Oct	+3.2 Dec	+3.5	+3.2	1.2 Sep
Argentina	+8.7 Q3	+11.7	+6.2	+4.7	+8.3 Nov	+8.5 Dec	+9.8	+11.4	7.5 Q4‡‡
Brazil	+5.7 Q3	+6.9	+4.5	+4.1	+6.7 Nov	+4.5 Dec	+3.1	+4.5	8.2 Nov‡‡
Chile	+4.1 Q3	−2.5	+4.5	+5.0	+4.2 Nov	+7.8 Dec	+2.6	+5.4	7.3 Nov††††
Colombia	+6.6 Q3	+6.9	+5.5	+4.4	+8.3 Oct	+5.7 Dec	+4.5	+4.7	9.4 Nov‡‡
Mexico	+3.7 Q3	+5.9	+2.8	+3.5	+0.8 Nov	+3.8 Dec	+4.1	+3.8	3.5 Nov‡‡
Venezuela	+8.7 Q3	na	+4.9	+3.9	+2.7 Sep	+22.5 Dec	+17.0	+24.0	8.5 Q3‡‡
Egypt	+6.9 Q3	na	+7.3	+6.6	+7.5 2007**	+6.9 Dec	+12.4	+7.5	8.8 Q3‡‡
Israel	+4.8 Q3	+6.1	+4.1	+4.6	+2.5 Nov	+3.4 Dec	−0.1	+2.8	7.3 Q3
Saudi Arabia	+4.3 2006	na	+6.0	+5.6	na	+6.5 Dec	+2.9	+5.0	na
South Africa	+5.1 Q3	+4.7	+5.1	+5.4	+4.4 Nov	+8.4 Nov	+5.4	+6.6	25.5 Mar‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	+6.4 Q3	+7.4	+4.3	+4.7	+4.4 Nov	+9.6 Dec	+5.1	+8.2	5.4 Oct
Finland	+4.1 Q3	+3.0	+3.2	+2.8	−1.4 Nov	+2.6 Dec	+2.2	+2.2	6.7 Dec
Iceland	+4.3 Q3	+9.9	+2.3	+3.0	+7.6 2006	+5.9 Jan	+6.9	+4.6	0.8 Nov‡‡
Ireland	+4.1 Q3	+5.6	+2.8	+2.9	+16.3 Nov	+4.7 Dec	+4.9	+3.0	4.7 Dec
Latvia	+10.9 Q3	na	+6.6	+6.5	+1.1 Nov	+14.1 Dec	+6.8	+10.5	5.0 Oct
Lithuania	+10.8 Q3	+10.0	+7.4	+6.5	na	+8.1 Dec	+4.5	+6.4	4.3 Dec‡‡
Luxembourg	+5.3 Q2	+5.3	+4.4	+4.8	−1.3 Oct	+3.4 Dec	+2.3	+2.3	4.4 Nov‡‡
New Zealand	+3.4 Q3	+1.1	+2.1	+2.7	+1.3 Q3	+1.8 Q3	+3.5	+2.6	3.5 Q3
Peru	+10.4 Oct	na	+6.5	+6.8	+14.2 Oct	+3.9 Dec	+1.1	+2.7	8.0 Nov‡‡
Philippines	+6.6 Q3	+1.1	+5.3	+5.4	−1.7 Oct	+3.9 Dec	+4.3	+3.5	6.3 Q4‡‡
Portugal	+1.8 Q3	−0.1	+2.0	+2.2	−1.6 Nov	+2.7 Dec	+2.5	+2.3	7.9 Q3‡‡
Slovakia	+9.4 Q3	na	+7.0	+5.7	+13.2 Nov	+3.4 Dec	+4.2	+2.7	8.0 Dec††
Slovenia	+6.3 Q3	na	+4.8	+4.0	+2.4 Nov	+5.6 Dec	+2.8	+3.4	7.3 Nov‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions. §RPI inflation rate 4.0% in Dec. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. §§New series.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

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The Economist commodity-price index

Jan 24th 2008
From The Economist print edition

The Economist commodity-price index

2000=100

	Jan 15th	Jan 22nd*	% change on one month	% change on one year
Dollar index				
All items	231.5	225.9	+2.8	+20.8
Food	230.7	226.9	+4.1	+44.1
Industrials				
All	232.5	224.5	+1.1	–0.2
Nfa†	182.9	180.7	+1.2	+18.2
Metals	259.8	248.5	+1.1	–6.0
Sterling index				
All items	178.1	174.7	+4.1	+22.4
Euro index				
All items	144.1	142.9	+1.1	+7.8
Gold				
$ per oz	909.75	892.60	+10.0	+38.2
West Texas Intermediate				
$ per barrel	91.74	89.70	–4.6	+67.1

*Provisional †Non-food agriculturals.

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Economic freedom

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From The Economist print edition

The global Index of Economic Freedom, put together by the Heritage Foundation and the *Wall Street Journal*, has made only modest gains since the mid-1990s. The Americas and Europe score highest in the 2008 rankings, some way above the world's other regions. Of the 162 countries covered, America ranks fifth—behind Hong Kong, Singapore, Ireland and Australia—and gets high marks for business freedom, flexible labour markets and property rights. Japan ranks in the top 20, though its position owes something to a dubiously high score for its low inflation. China rose in this year's rankings, closing the gap with India. Russia's score fell sharply from last year. Only North Korea is ranked lower than Cuba.

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Trade, exchange rates, budget balances and interest rates

Jan 24th 2008
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2008†	Currency units, per $ Jan 23rd	Currency units, per $ year ago	Budget balance % of GDP 2008†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−813.0 Nov	−752.4 Q3	−4.8	–	–	−1.7	3.74	3.42
Japan	+107.0 Nov	+212.9 Nov	+4.8	106	121	−2.5	0.74	1.34
China	+261.5 Dec	+249.9 2006	+10.9	7.23	7.77	0.1	4.50	4.62
Britain	−168.2 Nov	−129.4 Q3	−3.4	0.51	0.51	−3.0	5.48	4.42
Canada	+48.7 Nov	+16.3 Q3	+0.4	1.03	1.18	0.8	3.44	3.78
Euro area	+47.6 Nov	+38.2 Oct	+0.2	0.69	0.77	−0.9	4.29	3.88
Austria	+1.0 Oct	+11.3 Q3	+2.7	0.69	0.77	−0.6	4.33	4.00
Belgium	+18.4 Nov	+13.3 Sep	+2.3	0.69	0.77	−0.6	4.39	4.08
France	−51.7 Nov	−31.6 Nov	−1.3	0.69	0.77	−2.6	4.33	4.00
Germany	+268.1 Nov	+218.0 Nov	+5.6	0.69	0.77	0.8	4.33	3.88
Greece	−53.7 Oct	−43.2 Oct	−12.9	0.69	0.77	−2.5	4.33	4.26
Italy	−10.7 Nov	−43.1 Nov	−2.4	0.69	0.77	−2.6	4.33	4.27
Netherlands	+56.4 Nov	+57.2 Q3	+7.6	0.69	0.77	0.4	4.33	3.99
Spain	−128.7 Oct	−133.0 Oct	−8.9	0.69	0.77	0.1	4.33	4.07
Czech Republic	+4.1 Nov	−4.9 Nov	−3.6	17.9	21.6	−2.6	3.94	4.42
Denmark	+4.2 Nov	+4.0 Nov	+1.4	5.12	5.75	2.8	4.70	4.01
Hungary	−0.5 Nov	−6.8 Q3	−6.2	178	196	−4.4	7.51	7.20
Norway	+59.0 Dec	+59.9 Q3	+15.3	5.56	6.35	17.8	5.80	4.38
Poland	−11.8 Nov	−15.8 Nov	−4.1	2.50	3.00	−2.0	5.65	5.74
Russia	+128.2 Nov	+76.6 Q4	+4.0	24.7	26.5	1.0	10.00	6.21
Sweden	+18.7 Nov	+29.4 Q3	+6.4	6.54	7.00	2.3	3.97	3.90
Switzerland	+11.8 Nov	+69.6 Q3	+14.7	1.09	1.25	0.6	2.64	2.72
Turkey	−60.8 Nov	−35.7 Nov	−7.1	1.20	1.42	−2.9	16.60	6.12‡
Australia	−17.6 Nov	−49.9 Q3	−5.4	1.16	1.28	1.4	7.12	5.97
Hong Kong	−22.7 Nov	+26.9 Q3	+8.9	7.81	7.80	2.3	2.50	2.53
India	−67.9 Nov	−10.9 Q3	−2.0	39.6	44.3	−3.3	7.08	7.61
Indonesia	+40.3 Nov	+10.3 Q3	+1.9	9,390	9,078	−1.8	8.07	6.85‡
Malaysia	+29.9 Nov	+28.7 Q3	+12.0	3.28	3.50	−3.1	3.62	3.68‡
Pakistan	−15.2 Dec	−7.3 Q3	−6.5	62.4	60.8	−5.0	9.92	10.42‡
Singapore	+36.1 Dec	+46.3 Q3	+22.4	1.43	1.54	0.1	1.63	2.31
South Korea	+15.3 Dec	+7.2 Nov	+0.8	953	936	0.2	5.84	5.25
Taiwan	+16.7 Dec	+28.4 Q3	+5.9	32.4	32.8	−2.0	2.60	2.50
Thailand	+12.1 Dec	+14.4 Nov	+2.4	33.1	35.1	−2.1	3.50	3.90
Argentina	+11.2 Dec	+6.8 Q3	+1.7	3.16	3.10	1.2	12.56	na
Brazil	+40.0 Dec	+4.7 Nov	−0.1	1.81	2.13	−2.5	11.18	6.16‡
Chile	+24.5 Dec	+6.7 Q3	+4.0	478	540	5.4	6.36	3.87‡
Colombia	−1.8 Oct	−5.2 Q3	−3.8	1,996	2,258	−1.3	8.97	6.01‡
Mexico	−11.2 Dec	−7.5 Q3	−1.8	11.0	11.0	nil	7.39	7.67
Venezuela	+23.4 Q3	+20.2 Q3	+7.0	5.25	4,150§	−2.6	11.49	6.55‡
Egypt	−15.8 Q2	+2.7 Q2	+0.7	5.54	5.71	−6.9	6.34	5.17‡
Israel	−10.2 Dec	+5.9 Q3	+3.3	3.68	4.23	−1.4	4.37	5.44
Saudi Arabia	+146.6 2006	+98.9 2006	+21.8	3.75	3.75	12.0	3.53	na
South Africa	−10.0 Nov	−19.9 Q3	−7.5	7.11	7.17	0.6	11.40	8.44
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Estonia	−4.2 Oct	−3.2 Nov	−13.7	10.7	12.1	1.3	7.05	na
Finland	+13.1 Nov	+14.8 Nov	+4.7	0.69	0.77	3.0	4.15	3.98
Iceland	−1.6 Dec	−3.0 Q3	−11.0	67.0	68.7	3.9	13.85	na
Ireland	+37.2 Oct	−11.1 Q3	−3.2	0.69	0.77	−1.1	4.33	4.11
Latvia	−7.2 Nov	−6.5 Oct	−21.5	0.48	0.54	1.0	7.82	na
Lithuania	−6.9 Nov	−5.3 Nov	−14.2	2.37	2.66	−0.6	5.40	na
Luxembourg	−5.9 Oct	+4.7 Q3	na	0.69	0.77	0.9	4.33	na
New Zealand	−4.2 Nov	−10.2 Q3	−7.4	0.76	1.43	3.8	7.25	6.24
Peru	+8.3 Nov	+2.2 Q3	+1.4	0.34	3.19	1.5	5.25	na
Philippines	−4.3 Oct	+5.8 Sep	+5.2	41.3	48.9	−0.4	6.06	na
Portugal	−24.7 Oct	−18.6 Oct	−8.1	0.69	0.77	−2.6	4.33	4.17
Slovakia	−0.9 Nov	−3.5 Sep	−3.1	23.3	27.0	−2.3	4.46	4.29
Slovenia	−2.8 Nov	−1.8 Oct	−2.5	0.69	0.77	−0.8	na	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.
Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

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Markets

Jan 24th 2008
From The Economist print edition

Markets

	Index Jan 23rd	% change on one week	% change on Dec 29th 2006 in local currency	% change on Dec 29th 2006 in $ terms
United States (DJIA)	12,270.2	−1.6	−1.5	−1.5
United States (S&P 500)	1,338.6	−2.5	−5.6	−5.6
United States (NAScomp)	2,316.4	−3.3	−4.1	−4.1
Japan (Nikkei 225)	12,829.1	−5.0	−25.5	−16.1
Japan (Topix)	1,249.9	−4.0	−25.6	−16.2
China (SSEA)	4,936.0	−11.1	+75.3	+89.2
China (SSEB, $ terms)	318.9	−11.8	+127.1	+145.1
Britain (FTSE 100)	5,609.4	−5.6	−9.8	−10.2
Canada (S&P TSX)	12,657.4	−3.2	−1.9	+11.0
Euro area (FTSE Euro 100)	1,125.3	−11.8	−12.0	−2.8
Euro area (DJ STOXX 50)	3,578.0	−12.9	−13.2	−4.1
Austria (ATX)	3,685.2	−5.7	−17.4	−8.9
Belgium (Bel 20)	3,460.0	−9.0	−21.2	−13.0
France (CAC 40)	4,636.8	−11.3	−16.3	−7.6
Germany (DAX)*	6,439.2	−13.8	−2.4	+7.7
Greece (Athex Comp)	4,098.8	−9.4	−6.7	+3.0
Italy (S&P/MIB)	32,940.0	−10.1	−20.5	−12.2
Netherlands (AEX)	417.1	−9.8	−15.8	−7.0
Spain (Madrid SE)	1,329.7	−10.6	−14.5	−5.6
Czech Republic (PX)	1,405.1	−10.5	−11.6	+3.0
Denmark (OMXCB)	374.3	−3.9	−11.7	−2.5
Hungary (BUX)	23,080.7	−2.9	−7.1	−0.3
Norway (OSEAX)	445.1	−7.7	−11.4	−0.7
Poland (WIG)	45,362.1	−1.8	−10.0	+4.7
Russia (RTS, $ terms)	1,890.9	−15.0	−7.6	−1.6
Sweden (Aff.Gen)	289.4	−4.3	−20.8	−17.1
Switzerland (SMI)	7,356.1	−6.3	−16.3	−6.3
Turkey (ISE)	42,539.5	−13.4	+8.7	+28.1
Australia (All Ord.)	5,445.6	−7.2	−3.5	+6.8
Hong Kong (Hang Seng)	24,090.2	−1.5	+20.7	+20.2
India (BSE)	17,594.1	−11.4	+27.6	+42.7
Indonesia (JSX)	2,476.3	−4.5	+37.2	+31.4
Malaysia (KLSE)	1,354.5	−6.8	+23.6	+32.8
Pakistan (KSE)	13,787.0	−0.4	+37.3	+33.9
Singapore (STI)	2,983.6	−2.4	+2.2	+9.3
South Korea (KOSPI)	1,628.4	−4.5	+13.5	+10.8
Taiwan (TWI)	7,408.4	−9.4	−5.3	−4.8
Thailand (SET)	740.7	−4.3	+8.9	+18.8
Argentina (MERV)	1,891.3	−8.4	−9.5	−12.1
Brazil (BVSP)	54,234.0	−7.7	+21.9	+44.0
Chile (IGPA)	11,978.4	−5.4	−3.2	+7.8
Colombia (IGBC)	8,753.7	−8.7	−21.6	−12.0
Mexico (IPC)	27,620.3	+1.0	+4.4	+3.3
Venezuela (IBC)	35,754.5	−3.0	−31.5	−56.4
Egypt (Hermes)	89,454.8	−6.9	+46.0	+50.4
Israel (TA-100)	998.1	−6.9	+8.3	+23.9
Saudi Arabia (Tadawul)	9,360.4	−19.6	+18.0	+18.0
South Africa (JSE AS)	25,135.1	−6.6	+0.9	+0.1
Europe (FTSEurofirst 300)	1,262.4	−8.7	−14.9	−6.1
World, dev'd (MSCI)	1,397.2	−4.9	−5.8	−5.8
Emerging markets (MSCI)	1,055.2	−8.0	+15.6	+15.6
World, all (MSCI)	353.1	−5.3	−4.0	−4.0
World bonds (Citigroup)	754.4	+0.5	+14.6	+14.6
EMBI+ (JPMorgan)	435.0	−0.5	+6.8	+6.8
Hedge funds (HFRX)	1,278.8	−3.0	+0.2	+0.2
Volatility, US (VIX)	29.0	24.4	11.6	(levels)
CDSs, Eur (iTRAXX)†	74.3	+20.0	+218.6	+251.6
CDSs, N Am (CDX)†	130.1	+17.6	+289.2	+289.2
Carbon trading (EU ETS) €‡	20.0	−12.2	+9.7	+21.0

*Total return index. †Credit-default swap spreads, basis points.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CME; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac. ‡New series.

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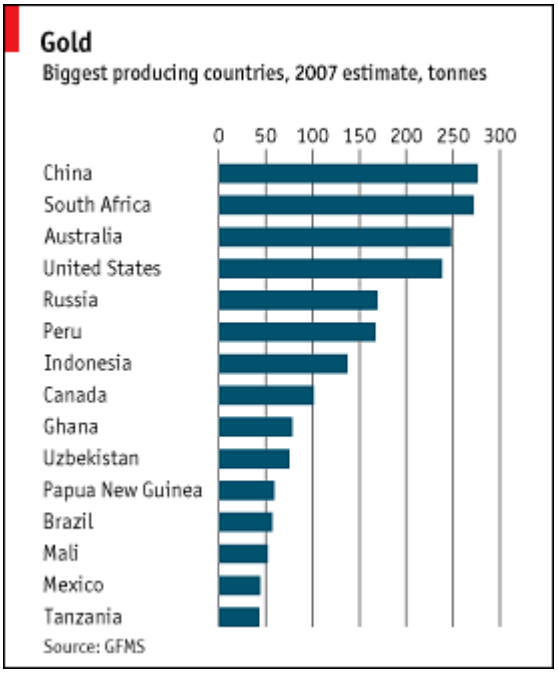
Gold

Jan 24th 2008
From The Economist print edition

World gold production fell by 1% in 2007, according to the latest Gold Survey from GFMS. Gold prices have risen to new highs this year, but fresh supply has been held back by a global shortage of mining professionals and equipment. China, where gold output rose by 12% last year, supplanted South Africa as the world's number-one producer—a position it had held for more than a century. South Africa's production fell by 8%, partly in response to tougher safety controls. Australia leapfrogged America, where output fell by 5%, to claim third place in the rankings. Peru's output fell below Russia's, after tumbling by 17% last year. Supply from Indonesia, Ghana, Brazil and Mexico increased rapidly.



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